

The Most Favoured-Nation Provision in the EC-EAC EPA and its Implications

Introduction

The Cotonou Agreement between the African Caribbean and Pacific (ACP) countries and the European Community member states (EC) signed in June 2000 (“the Cotonou Agreement”) provided the framework for new economic and trade cooperation between the parties. It was intended to establish a relationship that was *inter alia* compatible with the World Trade Organisation (WTO) provisions, where the parties are members. The Economic Partnership Agreement (EPA) between the EC and the East African Community (EAC) – this agreement will henceforth be referred as “the EC-EAC EPA”-that is currently being negotiated and of which an interim agreement has been initialled is a result of this process and is a Free Trade Agreement (FTA) in essence.

Parties to a FTA may decide to include a most favoured nation (MFN) clause in their agreement. This ensures that either party is able to benefit from better terms entered into by the other party with third parties. In the EPAs context the MFN Clause has its roots in the Cotonou Agreement, which provides for an MFN extension in favour of EC in the event that the ACP countries grant more favourable treatment to other developed states.

Generally, the MFN principle obliges a country to grant to the MFN beneficiary all trade advantages, such as low tariffs that any other nation receives from it. In other words, the MFN principle obliges country A to grant to country B all trade advantages that country A currently extends and will extend in the future to any other country. The party with MFN status (in our example, country B) will not be treated worse than any other nation. Use of the unconditional MFN clause in a number of European bilateral treaties, during the latter half of the 18th century, is credited for promoting a multilateral trading system. Among the advantages of

the MFN principle is that it protects the value of concessions received from future erosion, since any subsequent preferences entered into with third parties are automatically extended to the original parties as well.

Most FTAs typically apply the MFN clause in regard to investment provisions. However, it may also be stipulated for other matters such as the services sector (North American Free Trade Agreement); safeguard measures (US-Australia FTA); and price band system (EC-Mexico FTA). The clause has also been included in all the EPAs on similar terms.

The MFN Clause in the EC-EAC EPA requires EAC countries to extend to the EC any more favourable treatment that they may grant to developed and major developing economies other than the EC. Specifically, under Article 16(2) of the EC-EAC EPA, EAC countries are obliged to accord to EC any more favourable treatment resulting from an economic integration agreement with any “major trading economy”. Conversely, under Article 16(1), the EC is obliged to accord to the EAC countries any more favourable treatment contained in an economic integration agreement between the EC and third parties, with respect to the trade regime for goods.

The term “major trading economy” covers all developed countries, and any country accounting for a share of the world trade merchandise exports above one percent, or any group of countries acting individually, collectively or through an economic integration system accounting for a share of merchandise exports above 1.5 percent. To determine whether these numerical thresholds have been reached, the EC-EAC EPA stipulates that official WTO data on leading exporters in world merchandise be used. However, trade agreements between the EAC

Table 1: Major Trading Economies

Exporter	Share of exports in world merchandise trade
Korea	2.7
Russia	2.5
China	2.5
Singapore	2.1
Mexico	2.0
Saudi Arabia	1.7
Malaysia	1.3
United Arab Emirates	1.2
Brazil	1.2
Thailand	1.1

with ACP countries or other African countries and regions are excluded from this definition. With respect to these countries, there is, therefore, no obligation for the EAC countries to extend to the EC any more favourable treatment that may be agreed, even if the relevant numerical threshold has been reached.

Official data on leading exporters in world merchandise, published by the WTO, shall be used in the calculation of the major trading economies. Pursuant to 2007 statistics, the major trading economies that exceed the one percent threshold are as indicated in table 1.

In case of the EAC member states statistics indicate that imports from “major trading economies” are on the increase. Therefore, any greater trade preferences that may in the future be agreed upon with these countries will trigger the EPA MFN provision. This means that these greater preferences will have to be automatically extended to the EC. Table 2 shows the imports from some of the major trading economies over a three year period.

The EPA MFN Provision vs. the Enabling Clause

The differential and more favourable treatment reciprocity and fuller participation of developing countries decision of 1979 commonly referred to as the Enabling Clause permits derogation from the MFN principle allowing developing countries to enter into regional trade agreements among themselves. Under paragraph 2(c) it relevantly provides that regional or global arrangements may be entered into amongst less-developed contracting parties for the reduction or elimination of tariffs and, for the mutual reduction or elimination of non-tariff measures, on products imported from one another, without according such treatment to other contracting parties.

The question is whether the above provision is indeed an alternative legal basis for the formation of an FTA among developing countries and, hence whether the MFN clause as included in the EPAs effectively takes away this right from the developing countries that are categorised as “major economies” since any better preferences extended to them would have to be

Table 2: EAC Imports from Major Trading Economies (in US\$)

Country/Period	2005	2006	2007
China	791,486	1,044,245	1,621,065
ASEAN	557,829	1,112,495	1,350,517
Brazil	57,944	64,869	93,030
India	658,929	1,005,185	1,731,895

extended to the EC as well. This issue was raised by Brazil at the WTO General Council meeting of February 2008 and discussed in some detail by WTO Members.

Brazil, a country falling within the “major economies” category argued that the migration of trade preferences from schemes authorised under waivers to FTAs such as EPAs posed some questions and challenges, both to the ACP countries and to the broader WTO membership. Of particular concern to them was the MFN provision that obliges the ACP countries to extend to the EC, any treatment they may negotiate with third parties (“major trading economies”). That if the clause remained in the EPAs, it would be against the Enabling Clause whose main objective was to enhance trade among developing countries on a preferential basis.

Brazil also noted that the inclusion of the MFN clause in the EPAs came at the time when there is a major expansion of South-South trade. Therefore, prospects for promoting further growth through initiatives like the negotiation of FTAs; the extension by developing countries of duty free quota-free (DFQF) market access to LDCs and the current round of negotiations in UNCTAD of the Global System of Trade Preferences (GSTP) among developing countries. Hence, the MFN clause in the EPAs has the potential of undermining these initiatives and creating constraints to the development of South-South trade further hindering the integration of developing countries in the world trading system, one of the central objectives of the Doha Round and the EPAs themselves.

Other developing countries such as Argentina, India and China supported Brazil’s position and noted *inter-alia* that the implications of an MFN provision in the EPAs on the meaning and intent of the Enabling Clause would need to be assessed, since it was an important pillar of the multilateral trading system which should not be undermined in any way.

EC, on the other hand, responded to these concerns by stating that the EPAs were FTAs with asymmetrical liberalisation that had utilised the flexibility on WTO rules to allow all ACP economies adjust to liberalisation. It had opened its market to full DFQF imports the most generous offer in the history of trade agreements. The MFN clauses in the EPAs are limited in scope and concern only future FTAs that might be concluded by EPA parties with third countries considered “major trading economies”, that is countries competing with the EC and would have no negative impact on the overall South-South trade. The EC would also grant ACP partners more favourable treatment arising from

subsequent agreements concluded with any third parties. Finally, though the Enabling Clause permits preferential arrangements among developing countries, it did not prohibit the extension of the preferences to other members, in conformity with other WTO rules.

Specific Implications of the MFN Provision in the EPAs

The MFN provision, as included in the EC-EAC EPA, implies that any better preferences extended by the EAC to a “major trading economy” would have to be extended to EC, well as the EC would extend any better preferences that it negotiates with third parties, to EAC; however since the EC market access offer under the goods regime is DFQF, better preferences are not envisaged. On the EAC part this means that, for example, any better preferences it extends to a country like Brazil to export certain goods such as cars to its market free of tariffs, would equally apply to car imports from the EC, in its market. This means that a “major trading economy” Brazil would not have preferential treatment of its goods in the EAC market over the EC.

The above scenario is the bone of contention over the MFN clause, with the “major trading economies” arguing that it contravenes the Enabling Clause, though the EC argues that this is not the case. Whether or not the provision contravenes the Enabling Clause is debatable¹, what is clear is that EC seeks to prevent a competitive advantage over its products in the ACP market, from the “major developing economies”².

From the foregoing, the issue with the MFN clause in the EPAs is that it may slow down South-South trade since the “major trading economies” may not find any incentive to negotiate bilateral concessions with the EAC/ACP countries knowing that these would be taken advantage of by the EC rather than their own exporters; thus leading to slowdown in expansion/diversification of the export basket for EAC/ACP countries.

Conclusion/Recommendations

The MFN provision does not affect the trading relations between the ACP countries or between the EAC and other African countries or African regional trading blocs, whereby even if these regions were to graduate to the “major trading economy” category, the EC would not be entitled to trigger the clause.

All in all, the potential of the MFN clause as drafted, to slow down South-South trade and affect initiatives such as the ongoing GSTP negotiations, needs to be taken into consideration in reaching a final EC-EAC EPA, which would suit the trading interests of EAC.

The inclusion of the MFN clause as drafted in the EPAs is definitely a contentious matter. There is, hence, a need for further research to determine potential adverse impact of the clause by undertaking a line-by-line analysis particularly on tariff lines where the EAC has not given deep concessions to EC in the EPA market access negotiations. This would be useful in determining whether a better comparative advantage of EC

(whether due to subsidies or terms of trade or other reason) compared to the “major trading economies” would deter the latter from entering into bilateral/regional trade concessions with the EAC/ACP countries. Such an analysis would then be the basis upon which the MFN clause should or should not be included in the final EPA.

REFERENCES

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ENDNOTES

- 1 A counter-argument would be that paragraph 2 (c) of the Enabling Clause applies to ‘regional’ – like an FTA, or ‘global’ – like GSTP, arrangements amongst developing countries and not bilateral preferences amongst them
- 2 This may lead to a slowdown in the GSTP UNCTAD negotiations, since the “major trading economies” may be fearful of extending concessions to the EC through EPAs

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