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Agricultural Trade Issues in the forthcoming Trade Negotiations between the EU and the African, Caribbean and Pacific States

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Reform of the Common Agricultural Policy with a shift from massive price mechanisms to direct aid payments to European farmers is firmly on the EU agenda. This article argues that EU-ACP (African, Caribbean and Pacific) trade negotiations must take into account the heavy dependence of poorer countries on agriculture and that the EU must minimise the negative effects of any such reform on ACP suppliers by allowing them fair terms of access to European markets.

Introduction

Agricultural trade is central to trade relations between the EU and the African, Caribbean and Pacific states (ACP), with 36% of ACP exports to the EU being agricultural products. In addition agriculture constitutes the social and economic backbone of many ACP countries. Against this background, the process of CAP reform and the introduction of reciprocity in ACP-EU trade relations will have profound implications for ACP economies. With negotiations between the ACP and the EU now underway over the precise nature of future reciprocal preferential trade arrangements to succeed the current system of non-reciprocal preferences, an understanding of the nature of the process of Commou Agricultural Policy (CAP) reform and its implications for ACP-EU agricultural trade is now a matter of some urgency.

The trajectory for CAP reform

The current process of reform of the CAP involves moving away from a system of price support to one of direct aid to farmers. This involves making available direct aid to farmers, in ways which are compatible with the World Trade Organisation (WTO), either through "green box" or "blue box" measures.

Increased direct aid payments are made to compensate for reductions in EU intervention prices which aim to bring EU priccs down closer to world market price levels, without undermining farm incomes. By reducing prices and closing the gap between EU and world market prices, it is easier for EU producers and processors to export agricultural and processed agricultural products.

If the envisaged transition from price support to direct aid to farmers can be brought about across all sectors of European agriculture then this will result in a fundamental shift in orientation away from ensuring European food security (a concern now eclipsed by the end of the cold war confrontation in Europe), and incidental surpluses being exported with the benefit of publicly financed export refunds. Instead agriculture will be geared towards providing primary agricultural inputs into a European food and drinks industry orientated towards competitively serving world markets.

It should be noted however that this more "competitive" European food and drinks industry will remain dependent upon large volumes of public aid to the basic system of agricultural production. Indeed, Agriculture Commissioner Fischler has repeated on numerous occasions during the debate on the mid-term review of the CAP that the process of CAP reform is not about reducing support to the agricultural sector, but rather about re-directing its deployment to make it more efficient and effective in delivering the wider social goods which European agriculture is increasingly called upon to provide.

Significantly the forms which this re-directed aid will take are deemed by the European Commission to be less trade distorting than price subsidies and therefore the WTO should maintain its current tolerance of "green box" and "blue box" measures. However, from a developing country perspective the significance of the less trade direct aid payments is relative.

If direct aid payments improve the price competitiveness of EU suppliers and enable them to win contracts and supply markets which developing country producers and processors previously served, then the fact they are judged, at the macro-economic level, to be less trade distorting, will provide little consolation. The net effect will remain the same: ***developing country producers will have lost markets to EU companies producing, processing and exporting with the benefit of large scale public aid payments to the agricultural sector.***

Such an endgame for the current process of CAP reform would be an unmitigated disaster for ACP countries seeking to add value to basic agricultural raw materials, as a means of promoting more sustainable patterns of poverty-focused economic growth.

The external effects of CAP reform

An overview of the problem

The on-going process of CAP reform is having two important effects on ACP countries which have traditionally enjoyed significant preferential access to the EU market. Firstly, it is reducing the value of preferential access to that market, by reducing EU agricultural prices; secondly, it is making EU agricultural and value added food product exports more price competitive in domestic and overseas markets.

The impact of CAP reform is already being felt in both of these areas. However its effects are likely to be increasingly acutely felt by traditional ACP suppliers.

The declining value of preferences

According to Agriculture Commissioner Fischler the Agenda 2000 reforms in the beef sector have resulted in a 13% decline in average EU beef prices, while the BSE and FMD (foot and mouth disease) crises have accounted for a further 7% decline in beef prices. This clearly affects the returns on ACP beef exports to the EU market. Southern Africa beef producers have recently documented this.

Swaziland Meat Industries reported how the UK price of chilled steak cuts fell from Stg£4.05 per kg in the 1995/96 season to Stg£2.91 per kg in the 2002 season, (a 28% decline), while the price of forequarter frozen cuts fell from Stg£2.10 per kg to Stg£1.40 per kg (a 30% decline). In the case of Swaziland this resulted in the termination of exports of frozen fore quarter cuts when the EU price fell below £1.60 per kg (the price below which it was no longer profitable to export to the EU[1]). This results in an under-utilisation of the quota allocated to Swaziland. Similar price declines are reported on Namibian and Botswanan beef exports. For Namibia the prices received in sterling in 2001 compared to their first year of export to the UK resulted in an estimated annual income loss of N$ 60 million (or €6 million).

If the type of CAP reform introduced in the beef and cereals sector, involving reductions in the EU intervention price and increases in direct aid to EU farmers, were to be extended to the sugar sector, the Commission has estimated that with a reduction of the internal EU sugar price of 25% this would result in income losses to ACP sugar exporters of €250 million per annum. In the sugar sector purely in terms of income losses the worst affected countries will be those in Southern Africa. For Swaziland, for example, the annual income losses on sugar exports would be €25 million, almost as large as their "A" allocation under the 9th EDF.[2]

However, the worst affected in terms of their domestic economies are likely to be small and vulnerable island states of the Caribbean and Pacific which have high production and transportation costs and are particularly dependent on a high priced EU market. Should EU sugar prices be reduced these benefits will be correspondingly reduced and it will be

difficult for these high cost suppliers to find profitable alternative markets.

The overall effects of sugar sector reform on ACP economies, however, will depend on how the EU manages the process of reform, specifically how the reform process will affect EU production levels and EU exports. Certainly the experience in the cereals sector suggests that when direct aid payments are made to compensate for price declines, normal supply side responses do not occur and some peculiar effects can be felt, with production actually going up in response to the large increases in direct aid payments which accompany massive price reductions. In this context, given the significance of the sugar regime to ACP countries a strong case can be made for close ACP-EU consultations not only on the future of the Sugar Protocol but also the management of EU sugar sector reform.

Developing a policy response

In the face of the declining value of agricultural trade preferences under the impact of CAP reform, ACP agricultural policymakers are looking for an appropriate policy response. Consultations in Namibia between government officials and private sector bodies had led to the emergence of the concept of "compensatory trade measures".

Southern African beef exporters noted how while EU beef farmers have been compensated for these CAP-reform induced price declines, ACP beef exporters have not, and must carry the burden of lower EU prices themselves. While there is no suggestion from Southern African beef interests that direct financial compensation payments should be made to traditional ACP suppliers facing declining prices on the EU market as a consequence of the reform of EU agriculture, it is argued that the EU should introduce compensatory trade measures. From a Southern African beef sector perspective this could include such measures as:

- the abolition of the remaining 8% of the special duty (formerly known as the agricultural levy), which currently costs ACP beef exporters around €0.24 per kg of exported beef;
- a broadening of the beef product range which can be exported within the scope of the beef protocol, allowing the export of higher value products thereby reducing dependence on declining basic commodity markets;
- a reform of the licensing arrangements to allow greater flexibility to respond to market signals.

Compensatory trade measures could have a relevance to ACP agricultural exporters beyond the beef seetor. With the EU seeking a 50% reduction in the intervention price for rice (with EU rice farmers being compensated for 88% of the priee decline by increased direet aid payments), ACP tice exporters could usefully explore the notion of compensatory trade measures in the rice sector. Given the seeming inevitability of reform in the EU sugar regime before 2008[3] compensatory trade measures could also provide a framework within whieh governments of sugar dependent economies such as Swaziland eould attempt to manage the necessary process of adjustment required as a result of price reductions in EU sugar. Clearly dialogue with the EU on these issues within the context of the forthcoming trade negotiations would appear to be essential for a wide cross section of ACP countries.

The increased competitive threat

The nature of the change

The process of CAP reform is most advanced in the cereals sector. As a consequence this sector can provide an insight into what lies ahead. In the cereals sector since 1992 average EU cereals prices have declined between 45 and 50%, while total expenditures in the cereals sector have increased 75% (from €10,211.2 in 1992 to €17,865.9 in 1999). The shift from price support to direct aid to farmers has had the following effects:

- it has reduced EU cereals prices by on average between 45% and 50%;[4]
- it has reduced the need for export reforms (down from €3,281.8 in 1992 to €883.1 in 1999);
- it has reduced the costs of storing surplus cereals (down from €2,497.0 in 1992 to €712.7 in 1999).

However it has required a 75% expansion in the overall level of EU assistance to the arable sector (from €10,211.2 in 1992 to €17,865.9 in 1999).

The impact of change

Despite the substantial price reductions, reform in the cereals sector has seen EU production of cereals rise 18% (from 179

million tonnes in 1992/93 to 211.9 million tonnes in 2000). The process of CAP reform in the cereals sector has also promoted a renewed expansion of EU cereal exports to approaching pre-Uruguay Round levels (from 36,997,000 tonnes in 1991 down to 32,526,000 tonnes in 1993/94 back up to 36,800,000 tonnes in 1999/2000).

Table 1: EU exports of cereals, products of the milling industry and preparations based on cereals, flour, starch to ACP countries

Product Category (CN)	1996	1997	1998	% change
Cereals (CN 10)	243	216	216	- 11.2%
Products of Milling (CN 11)	201	333	336	+ 67.2%
Preparations (CN 19)	133	176	205	+ 54.1%

Source: *Agricultural Situation in the Community* Tables 3.6.12, 1999.

It has furthermore supported an expansion of cereal based food product exports to ACP countries (an expansion of 67% and 54% in the three years from 1996 to 1998 for CN 11 and 19 products respectively). This saw the importance of the ACP market to EU exporters of these products increased from12.6% to 20.5% of total EU exports for "products of the milling industry" (CN 11) and from 4.5% to 7% for "preparations of cereals" (CN 19).

Table 2: The changing pattern of arable sector expenditures

Year	Total	Export refunds	Storage	Export refunds as % of total	Storage as a % of total
1989	6,310.6	2,666.4	572.4	42	9
1990	7,869.4	2,501.0	1,253.2	32	16
1991	9,307.7	3,733.0	1,419.9	40	15
1992	10,211.2	3,281.8	2,497.0	32	24
1993	10,610.7	2,788.8	2,723.8	26	26
1994	12,643.7	1,513.2	178.1	12	1
1995	15,018.3	1,092.7	62.7	7	0
1996	16,372.2	312.8	- 46.5	2	-
1997	17,414.0	532.3	71.5	3	0
1998	17,945.2	429.4	1,083.9	2	6
1999	17,865.9	883.1	712.7	5	4

1. Totals from 1989-92 consist of cereals, plus oils and fats and protein products (excluding dried fodder) expenditures, (the vast majority of export refunds were on cereals).
2. From 1993 cereals, oilseeds and protein expenditures were reported together under the heading of arable.

Source: Extracted from *Agricultural Situation in the European Union*, Annual Reports, Table 3.4.4.

Looking to the future

The Agenda 2000 reforms currently under implementation in the cereals sector will see these basic trends further extended. In the coming years there will be *growing volumes of low priced EU cereal exports* placed on the world market against the background of continued high levels of budgetary expenditures in support of EU cereal producers. Indeed, recent reports from Southern Africa suggest that French wheat traders are now offering wheat for delivery in Southern Africa at 20% below the world market price.[5]

Similar trends are apparent in other value added food product sub-sectors. Yet these are simple value added food products in which ACP countries themselves could easily be developing production. As the process of CAP reform progresses these basic trends will intensify. What is more their effects would be compounded by the introduction of free trade with the EU in either basic agricultural products or value added food products.

Indeed, the very real danger exists that moves towards free trade under the circumstances created by a reformed CAP (with or without the introduction of free trade between the EU and ACP countries) could result in de-industrialisation in certain ACP countries and at a minimum will reduce the scope for the development of local value added food product industries.

The EU's proposed regional approach to economic partnership agreement negotiations further compounds the problem, for few ACP regions have common interests when it comes to agricultural trade with the EU. For example, in Southern Africa the implications of EU cereals sector reform vary greatly from country to country. For those countries with significant cereals production these changes could pose a threat to both basic agricultural production and the development of cereals-based value added food product industries. For those countries such as Mauritius and Botswana, which have no significant domestic cereal production, cheap EU cereals provide the raw materials for domestic food processing industries serving both national and regional markets.

The question arises: how can these different ACP interests be reconciled under any forthcoming regionally negotiared economic partnership agreement? In the context of the negotiation of reciprocal preferential trade arrangements with the EU the external effects of a reformed CAP are likely to require extensive exclusions of cereal-based products from the coverage of any free trade area agreement and the inclusion of strong yet simple safeguard provisions. It may even require the establishment of special arrangements in products sensitive to the new patterns of CAP distortions. It will certainly require detailed discussion and dialogue over the likely trajectory of CAP reform in the cereals sector and how best to manage the external consequences of this reform.

Acknowledging and addressing the issue

The importance of the external effects of a reformed CAP on the development of future ACP-EU trade relations and the structural transformation of ACP economies needs to be recognised in the forthcoming trade negotiations. Clear provision needs to be made

for the issue of the external effects of a reformed CAP on ACP countries to be comprehensively discussed and addressed as an integral part of Economic Partnership Agreement negotiations. Such a commitment from the EU would in no way undermine its sovereign rights to determine its own internal agricultural policy. It would simply constitute an acknowledgement that this internal EU policy has external implications, which, in the spirit of partnership, need to be taken up and addressed within any process of ACP-EU trade negotiations.

Currently within the Commission's approach to economic partnership agreement negotiations little consideration is being given to addressing the issue of the impact of CAP reform on ACP countries under moves towards free trade with the EU. The only reference to these issues in the European Commission's instructions for the negotiations with the ACP is to examine "on a case by case basis, the potential impact of export refund mechanisms on the process of trade liberalisation". However this effectively wholly ignores where the process of CAP reform is actually taking the EU in terms of agricultural support. Over time, as EU prices are brought down to world market price levels the issue of export refunds will become less and less significant, since fewer and fewer products will require export refunds in order to clear EU markets. However, as evidenced in the cereals sector, continued high levels of direct aid payments can fundamentally shift the supply response of EU farmers so that at any given price level farmers are willing to produce a far higher volume of production than would be the case without such high levels of direct aid payments. To the extent that this is replicated in other sectors this will pose major problems for agriculture-dependent developing countries entering into free trade area arrangements with the EU.[6] Against this background the EU's current approach to dealing with the external effects of a reformed CAP is wholly inadequate given the impact which the shift away from price support to direct aid payments is having on the price competitiveness of EU products on ACP markets and the attractiveness of the EU market to ACP exporters.

A much clearer EU commitment to an open discussion of the implications of CAP reform for ACP countries as an integral part of the forthcoming trade negotiations is needed if the negative effects of CAP reform on traditional ACP suppliers are to be minimised. It is to be hoped the Irish Government will be able to give a lead on this issue in the run up to the Irish Presidency of the EU Council of Ministers in 2004.

Footnotes

1 This price is in part affected by the Stg£/rand exchange rate.

2 Swaziland "A" allocation under the 9th EDF (2001-2007) is €31 million, with a "B" allocation of €12 million.

3 The Brazilian and Australian challenge at the WTO is likely to alter the context in which the Commission develops its proposals for sugar sector reform in 2004. Since 1992 the Commission has been putting forward proposals for fundamental reform of the sugar regime in line with the new trajectory for CAP reform but has been consistently balked by industry and member states' resistance to change. A successful challenge at the WTO would increase both member states' and the industries' openness to reform proposals.

4 With the Agenda 2000 reforms now fully implemented this is now nearer a 50-55% reduction.

5 This comes at a time when the EU is reviewing how it calculates the world reference price in the face of the availability of large quantities of low priced "black sea" wheat.

6 It should be noted that there is something profoundly unreal and unjust about even talking of free trade when one party, the EU, in a sector of vital importance to its trading partners – the ACP – is providing annually over €40,000 million in support to its agricultural producers and processors. The distortions in production and trading decisions this creates makes a mockery of the concept of free trade, which is about doing away with all forms of distortion (not simply those generated by tariffs) and allowing markets to freely operate and freely develop.