AAAE Conference proceedings (2007) 529-536

Effects Of EU's Common Agricultural Policy Reforms On Prospects For Eastern And Southern Africa's Trade With The EU Under The Economic Partnership Agreements

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Abstract

Due to the size of the European Union's agricultural production and its market, the impact of the EU's Common Agricultural Policy (CAP) reaches far beyond Europe and has major implications for trade in agricultural goods all over the world including the ESA region. Since the 1950s, the CAP has undergone several reforms which have not only changed EU's agricultural support system drastically but has also impacted global agricultural markets. For developing countries including the ESA ones, these reforms have serious implications since they are particularly locked into the EU's complicated system of protectionist regulations and subsidies on the one hand and preferential market access on the other hand. The high degree of dependency and vulnerability of ESA agricultural industries thus created makes it well worth having a closer look at the changing patterns of the CAP and their impact on ESA agricultural markets. Moreover, the impact of the CAP reform on ESA markets is likely to be complicated by the introduction of free trade arrangement with the EU through the Economic Partnership Agreements (EPAs) which are to become effective on January 1 2008. A free trade agreement will reduce the scope for the development of local value added food product industries serving national, regional and EU markets and thus worsen ESA countries' overall terms of trade with the EU. It is this process of trade liberalization in food and agricultural products in parallel with external effects of CAP reform which raises concerns as ESA countries strive to structurally transform their economies

Introduction

The European Union (EU) is one of ESA (The ESA countries are part of the African, Caribbean and Pacific (ACP) countries that have had trade relationship with the EU defined by the Lome Conventions and the Cotonou Partnership Agreement . These relationship is to be replaced by EPAs from January 1 2008. In this paper, ESA and ACP may be used interchangeably.) countries' major trading partners. In value and volume terms, the EU is an important destination for ESA countries' agricultural exports and that agricultural products are central to ESA countries' trade relationship with the EU. Likewise, the EU has vast potential to export agricultural products to ESA countries (Echessah, 2005).

In view of the importance of the EU as an export destination for ESA countries' agricultural products and the role the EU plays as an exporter of basic agricultural and value-added food products, policy changes in the EU's agricultural sector, through the Common Agricultural Policy (CAP), are likely to affect ESA countries' economies. Given the size of EU's agricultural production and its market, the impact of its CAP reforms have serious social and economic ramifications on ESA countries' national economies in general and the agricultural sector in particular. The agricultural sector is the backbone of ESA countries' economies.

CAP reform is likely to be complicated by the introduction of free trade arrangement with the EU through the Economic Partnership Agreements (EPAs) espoused in the Cotonou Agreement (CA) and which are to become effective on January 1 2008. The impact of CAP reforms on ESA economies needs to be seen against the background of the continuum of efforts to promote trade and economic liberalization in Africa which are at the centre of EPAs. A free trade agreement will reduce the scope for the development of local value added food product industries serving national, regional and EU markets and thus worsen ESA countries' overall terms of trade with the EU. It is this process of trade liberalization in food and agricultural products in parallel with external effects of CAP reform which raises concerns as to the consequence for efforts to structurally transform Africa (Alpha *et al.,* 2007)

The importance of agricultural trade for ESA countries

The starting point for looking at the issue and options for ESA arising from the process of CAP reform has to be the ESA region's own objectives for the development of regional agricultural production and value added processing activities. This is because for

most of the ESA countries, agriculture is central to their economies. In most ESA economies, agriculture is the main source of employment, a major contributor to GDP and foreign exchange earnings and the foundation for the national industrial development. The importance of agriculture to the EU-ESA relationship can be seen from the percentage share of agricultural products in total exports to the EU, which ranges from 10.2% (Djibouti) to 98.6% (Malawi) with an average dependency on agricultural exports to the

EU for ESA as a whole of 60.6% of the total exports (Table 1).

In most ESA countries, the agricultural sector is the foundation for any process of structural transformation which the ESA region may wish to bring about in the coming years. It is assumed that the objective of ESA region's trade policy (including the negotiation of the EPA with the EU) is to support the structural transformation of the ESA region's economies, so that they progressively add more value to the goods and services produced, for the local, national, regional and international markets, with consequent gains in employment, rural incomes and economic growth.

Current major issues in ESA countries agricultural trade

While the agricultural sector is obviously important, its ability to continue to contribute sustainably to economic development will depend in particular on the ability of the ESA countries and regions to meet a number of challenges connected with agricultural trade. These challenges can be grouped under two headings: ESA product access to external markets and competition from imports in national and regional ESA markets (Alpha *et al.,* 2007). These challenges are briefly discussed below solely from the ACP-EU agricultural trade, as the EU is the main trading partner in at least the four of the six ACP regions (African regions).

Preference Erosion: For over thirty years, ESA countries, under the framework of ACP countries' trade relationship with the EU, have benefited from trade preferences in the EU market under the Lomé Conventions and the Cotonou Agreement. The value of these preferences is currently being eroded for three different reasons: multilateral trade liberalisation within the WTO; bilateral trade liberalisation (as a result of the free trade agreements (FTAs) which the EU is concluding with other trading blocs; and, CAP reform.

Although the impact of these factors differs for different products and for different countries, they are nevertheless a matter of serious concern for the ESA countries.

Tariff and non-tariff barriers: Over and above the problem of preference erosion, the ESA countries have to cope with a whole series of constraints connected, on the one hand, with residual tariffs on some export products and, on the other hand, with the rules of origin and the sanitary and phytosanitary (SPS) measures imposed by the European market.

Although the Cotonou Agreement allows duty-free access for most ACP (including ESA) exports, this principle is subject to restrictions for some sensitive products for which there continue to be tariff barriers (special duties).

Although this is an issue which in practice involves only the non-LDC ACP countries (as the LDCs benefit from the EBA initiative), it is nevertheless an important one for some countries (for instance table grapes from Namibia).

The second type of constraint, connected with rules of origin and the question of SPS standards, applies to all the ACP countries.

The rules of origin and cumulation conditions which shape the duty-free access of ACP products to the European market have long been and in some cases still are a major barrier to ACP exporters. These rules are particularly significant in the field of added value food products for which packaging products account for a significant proportion of the cost of the finished product.

SPS standards are becoming an increasingly important issue, especially as European regulations are becoming tougher and tariff barriers are being substantially reduced. Technical standards (for instance the quality of packaging) are also tending to place real barriers in the way of exports from the ACP countries. The standards applied in Europe are felt to be very strict, and much tougher overall than international standards. The entry into force in January 2006 of the Community Regulation on official controls performed to ensure the verification of compliance with feed and food law, animal health and animal welfare (882/2004) is, for instance, placing two major barriers in the way of the ACP countries: (i) exporting enterprises'

compliance with the EU's technical health safety standards for foodstuffs; and, (ii) institutional capacity in terms of certification and verification of compliance.

In addition to European public standards, private standards imposed by economic operators under codes of conduct are proliferating. Importers and large retail chains in the EU were including the EU's legislative requirements in sectoral codes of practice (Eurepgap, for instance) which very often went beyond health and safety concerns to include social and environmental requirements under the pretext of compliance with SPS standards. The cost involved in complying with these standards may be too high especially when export volumes are relatively small.

Import Competition: The challenges connected with the European market access of ACP products are being exacerbated by further challenges from competition from imported products in the markets of ESA countries; this competition is often branded unfair because of the domestic and export subsidies practices used by the developed countries and the EU in particular. This issue is closely linked to the reform of the EU's CAP (see below) which is of crucial importance in particular for the African ACP countries which are closely linked to the EU market in terms of both imports and exports.

While this trade may be a source of low-cost imports and help to improve food security especially in the net-food-importing developing countries (NFIDCs), its effect may also be to weaken the industrial development base provided by agriculture in the ACP countries; in turn, this has repercussions on employment and livelihoods in rural regions.

Problems connected with production capacity: To conclude, trade potential in the ESA countries, especially that of LDCs , is being undermined by low production capacity despite potential improvements in terms of market access and import competition.

Supply-side problems in general range from the lack of public infrastructure (obsolete road and rail networks), high transaction costs, the lack of reliable public services (electricity and water supplies, for instance), costs arising from the lack or shortcomings of institutional and political frameworks (leading to corruption, exchange rate fluctuations and high inflation) and low labour productivity (which can be explained by the lack of education and health facilities and accommodation).

In the agri-food sector in particular, adverse meteorological conditions combined with the lack of irrigation systems, the instability of the land system, low technological levels and weak institutions are having a direct impact on the production capacity of the ACP countries. Their processing and marketing capacity is also very limited because post-harvest and processing equipment and technologies are lacking, and market information systems are inadequate and lack reliability. While the lack of financial resources and capital is also a major aspect, their capacity to manufacture high-quality products is undoubtedly one of the main challenges facing ESA exporters of agricultural products. The institutional capacity of ACP governments to efficiently verify compliance with the EU's health safety standards for foodstuffs in order to provide certification seems to be a particularly significant point in this respect.

Problems linked with production capacity are therefore a very significant issue for the ACP countries in general and ESA countries in particular, and should be a major focus of EPA negotiations.

Understanding the Common Agricultural Policy (CAP)

The CAP is a set of rules and mechanisms, which regulate the production, trade and processing of agricultural products in the EU, with attention being focused increasingly on rural development. Among the EU's policies, the CAP is regarded as one of the most important policy areas. Not only because of its share of the EU budget (almost 50%, decreasing over the years), the vast number of people and the extent of the territory directly affected, but also because of its symbolic significance, and the extent of sovereignty transferred from the national to the European level.

The objectives of the CAP are to: increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilization of the factors of production, in particular labour; ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture; stabilize markets; assure the availability of supplies; ensure that supplies reach consumers at reasonable prices (ERS/USDA, 2004).

The policy instruments used by the EU to achieve the objectives of CAP reforms are intervention in prices, variable or fixed export subsidies (refunds), import tariffs, production quotas, set aside, direct payments, and safeguard measures, among others.

The policy covers agricultural products, which, by mutual agreement of the EU Member States, are subject to the common organization of the EU market (COMs). Currently, it covers arable agriculture (cereals, cotton, fibre flax and hemp, flowers and live plants, fruit and vegetables, honey, hops, oilseed, olive oil, peas, field beans, lupins, potatoes, rice, seed, seed flax, silkworms, sugar, tobacco and wine) as well as meat and dairy (beef and veal, milk and milk products, pig meat, poultry meat and eggs, sheep meat and goat, meat, animal feed stuffs and dried fodder).

The CAP Reform

The CAP succeeded in reaching its initial goals: it encouraged both production and productivity, stabilized the markets, secured supplies and protected farmers from fluctuations in world markets. Nevertheless, along with the success came undesirable side-effects and problems: EU farmers were producing more than the market could bear, creating excessive surplus and EU spending in agriculture increased exponentially. The CAP also sustained high internal EU prices. All these were a result of high support prices provided under the traditional CAP (Green and Griffith, 2002).

The traditional form of the CAP had a two-fold effect on ACP countries: it qualified and limited the duty free access granted to ACP countries for agricultural products; and it increased the value of the preferential access ACP countries were granted, since it sustained high internal EU prices, from which ACP exporters could directly benefit.

As a result of excessive surpluses and increasing EU spending on agriculture, the CAP has undergone several reforms. The first reforms were undertaken in late 1960s, early 1970s and early 1980s. However, it is only since 1991 that the EU started a fundamental shift in its agricultural policy from a system of incentive pricing towards various systems of direct aid payments to farmers.

The EU's agricultural trade policy is closely linked to the CAP and the reform process which has been under way since the 1990s is intended to:

- lower intervention prices, i.e. the threshold price from which the Union intervenes to support European internal prices or guaranteed prices. This tends to close the gap between domestic prices and world prices;
- compensate for intervention price reductions by direct aid which is unconnected with price levels or quantities produced (decoupled aid);
- reduce duties on imported products as there is less need to protect the European internal market to support prices (because guaranteed prices are lower);
- reduce export subsidies which have also become less necessary because European products are more competitive as guaranteed prices are lower.

The reform is, however, not aimed at reducing the overall support to EU farmers fixed in the financial outline for the upcoming years. The financial ceilings for overall support remain unchanged. They account to €46,449 billion for the 2003 budget year and slightly decrease to €44,209 billion for the budget year 2006, a level at which the farm budget will be fixed until the 2013 budget year (all figures including rural development measures).

Effects of CAP Reform in EU

The move over to a single system of farm payments de-coupled from the production of any individual product is likely to exert a downward pressure on internal EU market prices for all products currently falling under the CAP.

The substantial lowering of the price of EU produced agricultural raw materials, at the same time sustaining, and in some cases, increasing the overall level of EU production of these products increases the price competitiveness of EU exports of both basic agricultural and simple value added food products. These reductions in prices generated by CAP reform make the raw material costs of EU food and drink manufacturers cheaper, leading to an expansion (diversification) of simple value food product exports from the EU to the ACP in product chains linked to the basic agricultural raw materials whose price has fallen.

The process of price reductions induced by CAP reform reduces the need for EU export refunds and

high levels of tariff protection, which then brings the EU's agricultural policy more into line with the WTO provisions. This in large part accounts for the EU's recent proposals at the WTO to reduce expenditures on export refunds by 55% and reduce agricultural tariffs by an average of 36%.

The strengthening of sanitary and phytosanitary controls and the shift towards more quality production in the EU form an integral part of the process of CAP reform. The taking into account of increased consumer concerns over food quality and safety, environmental protection and animal welfare in farming has led to the strengthening of EU's food safety policy. The strengthened food safety policy not only has serious cost implications to EU farmers, but also ACP countries' exporters to that market.

Impact of CAP Reform on ESA countries and other ACP Countries

One of the key impacts of CAP reform on ESA countries and other ACP countries is the erosion of the value of preferences as a result of the reduction in internal EU prices arising from the shift from price support to direct aid payments. This situation is compounded by the increased costs ACP exporters have to carry in order to comply with increasingly strict EU hygiene standards. The very real danger is that ESA exporters could find their profit margins squeezed between the declining value of preferential access and the increasing cost of supplying the EU market.

The rapidly evolving and stricter SPS measures arising from strengthened food safety policy have cost implications for developing country suppliers. The burden of these additional costs falls particularly heavily on small, poor and least developed countries where production runs are generally smaller than in Europe. This situation is further compounded by the weak institutional arrangements that obtain in these countries. This is an issue which potentially threatens to undermine the benefits of trade preferences which the EU extends to least developed, poor and small developing countries. It is thus an issue which needs to be urgently addressed, if such countries are to gain any meaningful benefits from the process of global trade liberalization underway within the context of the WTO.

Finally, the lowering of the EU internal prices of produced products and agricultural raw materials ultimately leads to increased and diversified production of simple value added food products that are very competitive on both domestic and international markets. As a result, the ESA region is witnessing higher imports of value added products into the region from the EU. For example, between 1996 and 2002: EU exports of meat products to ACP countries increased in value terms by 121% and the importance of the ACP market increased from 3.5% of total meat product exports to 6.9% of total meat products, with this expansion of trade mainly concentrated in poultry meat exports; EU exports of "products of the milling industry" rose by 83% in value terms; and, EU exports of "preparations of cereals" rose by 163% in value terms.

With the further reform of CAP in the sugar and dairy sectors, the EU will further increase its competitiveness in value-added food products and this will have serious and far-reaching implications on regional trade policy

Policy Options for ESA countries

ESA countries and other ACP countries are negotiating EPAs with the EU. It is therefore essential that the external effects of CAP reform be taken up and addressed as an integral part of the EPA negotiations. The effect of increased competitiveness of EU agricultural producers on ESA industries will even be higher under reciprocal conditions (EPAs) since this inevitably means the elimination or reduction of protective tariffs, which currently still benefit these industries. Apart from the declining value of preferences due to CAP changes, at least for the non-LDCs in ESA, the continuation of preferential access to the EU market is uncertain and subject to the outcome of the EPA negotiations.

EPA negotiations: ESA countries and other ACP countries need to find the balance between consumer interests and industry protection. In the on-going EPA negotiations, it may be necessary to exclude certain products from the free trade commitments. In the SA-EU TDCA, for example, wheat flour was excluded from the liberalization commitments. A similar approach could be sought in future EPA negotiations as far as wheat, rice, sugar dairy, maize, meat and meat products as well as cereals based value added food products are concerned.

Regional Integration Policies: With European markets possibly becoming less attractive in some sectors, the

development of local and regional markets is a key factor for the development of the agricultural sector. The full potential of regional markets in ESA is currently far from being effectively used and could prove to be a major growth factor if certain trade impeding factors were to be removed. ESA member countries, through regional trade blocs, should adopt policies and implement measures to eliminate all existing forms of non-tariff barriers and refrain from imposing new ones (Malzbender, D. (2003).

Foreign Direct Investment: A final consideration would be to encourage EU Member States to invest in ACP countries to utilize the abundant raw materials that obtain in these countries. This presupposes putting in place investment incentive structure coupled with the general improvement of business environment by addressing some of the factors affecting the country's export performance referred to earlier.

EPA Negotiation Position Based on Impact of CAP Reforms

Different negotiating options

Various flexibility measures will need to be drawn up for this purpose

- exclusion of "sensitive" products for the ESA countries, over relatively long periods depending on the degree of sensitivity or competitiveness of products; i.e. different progressive liberalisation timetables for different products;
- a timetable revision clause if local products do not become competitive enough and do not enable, as expected, fair competition;
- a flexibility clause to cover reforms of the CAP which have potentially adverse consequences for the ESA countries;
- a special safeguard mechanism under which it is possible to apply additional duties or even quantitative restrictions on European imports if there are massive rises in import volumes or substantial price drops.

Towards a development package

The accompanying measures making up the development strand of an EPA should be geared towards two objectives: making local sectors more competitive and developing regional trade. More competitive local ESA sectors are a must if genuine benefits are to be gained from the European market access opportunities offered by an EPA and if competition from European imports is to be withstood. Structural supply constraints need to be eliminated if competitiveness is to be improved. For some products and in some ESA countries, there is, moreover, a real regional trade dynamic which needs to be preserved and enhanced. An EPA could be signed only if its development strand includes sufficient guarantees of actual implementation of a package of accompanying measures geared towards these two complementary objectives. Accompanying measures could be of various types:

- measures helping to make local products more competitive in terms of price and quality: enhancing local products, respect of contractual deadlines, regular supplies, etc. ;
- measures covering the key aspects of SPS standards and compliance with European regulations;
- measures fostering trade at regional level: assistance with computerisation of customs systems, simplification of administrative procedures, and infrastructure.
- targeted sectoral restructuring assistance designed to help ESA countries and other ACP countries to adjust to the market changes which will be brought about by CAP reform.
- compensatory trade measures as a policy response to the erosion of the value of trade preferences for ESA countries and other ACP countries (traditionally preferred partners) arising from the process of CAP reform, through the utilization of the provisions set out in Declaration XXII, the "Joint Declaration Concerning Agricultural Products Referred to in Article 1(2) (a) of Annex V" (ACP-EU (2000). These compensatory measures can be either sector specific or country specific. In the absence of an across the board initiative

to provide complete duty, special levy and quota free access to all ACP exports, specific programmes of compensatory trade measures designed to open up markets in areas where countries facing adjustment problems have a genuine export interest or potential should be introduced.

- improving the effectiveness of EU support to necessary restructuring of sectors in developing countries adversely affected by the process of CAP reform by reviewing and reforming aid deployment and management arrangements of EU assistance.

Towards an EPA fostering ESA agriculture

An "ideal" agreement on agriculture in the EPAs would obviously be an agreement containing more gains than risks: in other words an agreement which would maximise European market access opportunities and make it possible not just to mitigate the risks of competition in local and regional markets but rather to strengthen these markets in a way which is consistent with the objectives of regional agricultural policies. This means:

- Negotiating the complete opening-up of European markets, without quotas or duties; this would involve extending the EBA scheme to the non-LDC ACP countries.
- Excluding all products deemed to be sensitive, and not just within the 20% limit connected with the EU's interpretation of Article XXIV of the GATT. It would be advantageous in particular to be able to raise the levels of duty on products excluded from the EPA. This may involve amending the structure of the Common External Tariff (CET) decided by the ESA region if the maximum levels do not in future provide adequate protection against competition from European imports.
- Ensuring that European export aids (subsidies and financing) are effectively abolished as soon as tariffs on European imports are abolished. In practice, export subsidies make European imports particularly competitive on local and regional markets. Abolishing tariffs on these products would undoubtedly exacerbate unfair competition.

Lastly, with a view to an "ideal" EPA on agriculture, all the alternatives to an EPA should be examined when negotiating an agreement, whether the EBA initiative, the GSP or even the possibility of obtaining a third WTO derogation in respect of the Cotonou regime.

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Table 1: Food and Agricultural Exports to the EU as a % of total exports to the EU – 2002 ('000 Euro)

Country	Agricultural exports	Total exports to EU	% share
Malawi	174,391	176,849	98.6
Zambia	59,805	115,390	51.8
Zimbabwe	412,577	610,850	67.7
Mauritius	406,575	1,342,027	30.3
Seychelles	255,265	258,171	87.3
Burundi	17,269	18,650	92.6
Comoros	14,438	18,896	77.4
Djibouti	458	4,475	10.2
Eritrea	1,921	6,308	30.5
Ethiopia	108,796	189,981	57.3
Kenya	639,584	848,186	75.4
Madagascar	324,424	530,452	61.2
Rwanda	17,079	21,779	78.4
Uganda	218,520	260,679	83.8
Sudan	87,259	264,577	33.0
Total	2,708,361	4,467,270	60.6