



The Impact of Common Agricultural Policy (CAP) Reform on Africa-EU Trade in Food and Agricultural Products

This paper seeks to look at certain fundamental features of the EU food and agricultural sector adjustment process as it manifests itself through the reform of the CAP. It highlights the shift in policy tools, from price support for agricultural products to income support for EU farmers and the shift in policy emphasis from the quantity of agricultural products to the quality of food and agricultural products. It reviews the implications of this policy shift for the EU's diminishing tolerance of the use of trade policy tools as part of agricultural development policies in third countries. It highlights in passing the implications of these developments for the African food and agricultural sectors, before drawing out some broad conclusions and recommendations

Introduction

Viewed from an African perspective the process of reform of the EU's common agricultural policy (CAP) can best be seen as a long-term 'structural adjustment programme' for the EU food and agricultural sector. The aim is to bring about a fundamental transformation of the basis on which the sector engages with the global economy, in the era of agricultural trade liberalisation, so as to establish a sustainable and profitable basis for its future operation.

However, this EU structural adjustment programme for its food and agricultural sector has a number of notable features which would be unrecognisable in an African context. The first unrecognisable feature is the *time frame for adjustment*. The current process of CAP reform was initiated in 1992¹ and is still ongoing in 2009. In all, some 25 years will have past by the time the CAP reform process is approaching completion.

The second noticeable feature is the *massive level of public sector financial assistance* deployed in support of the CAP reform process. Since 1992 annual EU public assistance has expanded from around €32 billion per annum to €55 billion per annum, with approximately a further €10 billion in co-financing being deployed directly from member states' national budgets under rural development initiatives, and substantial additional targeted assistance being deployed through purely national programmes. This is equivalent to

seven times the value of sub-Saharan Africa's food and agricultural exports to the EU in 2007.

The third notable feature is the maintenance of a *supportive trade policy framework*, alongside the reform process. EU trade policy tools are kept in place until such time as the internal reform process and favourable economic circumstances remove the need for their continued use. Two developments illustrate this point. First there is the decision to exclude sugar, rice and bananas from the duty free/quota free access granted least developed countries (LDCs) under the EU's 2001 Everything But Arms initiative. These three commodities were the only major products which by 2001 had not yet been made subject to reform. Thus the phasing out of quota restricted access for some of the weakest trading economies in the world – the LDCs – was closely sequenced with the implementation of substantive reforms in the sectors concerned. The second illustrative development was the EU's decision during the 2007/08 global price surge to *set tariffs for certain cereal products and export refunds for certain dairy products at zero*. This step was taken because market development made tariff protection and export refunds unnecessary. When global prices fell precipitously, tariff protection and export refund support was duly reintroduced. This highly cautious approach involved suspending the use of an instrument, but retaining the basic system in place so that if necessary it could be reactivated.

This has important implications for the commitments African governments are being called upon to make in the EPA negotiations. As part of its wider trade policy the EU is seeking the abandonment or restriction of the use of a range of trade policy measures, from tariff protection, through import licensing arrangements and export taxes to infant industry protection and special agricultural safeguards, regardless of the role of these tools in current agricultural development policies in African countries. This is at variance with the EU's own internal practice, where trade policy tools are retained until such time as domestic reform processes are completed and their use is no longer required.

The EU's CAP process has both short-term and long-term implications for Africa-EU trade in food and agricultural products, with both immediate market impacts and longer-term agricultural policy implications. These developments in turn have long-term implications for the African food and agricultural sectors.

1. This followed the end of the Cold War, which did away with the need for a policy focus on European food security.

The Changing Nature of the CAP and its Consequences for Africa

From Price Support to Direct Aid Payments

The most fundamental change in the CAP since 1992 has been the gradual shift from *price support for EU agricultural products to income support for EU farmers*. The old system of price support required a highly protective tariff regime, to prevent third-country agricultural products from flooding the high-priced EU market. However, the high prices served to stimulate production in the more efficient agricultural areas of the EU, while at the same time lowering demand for EU-produced feed products for the livestock and industrial sectors. This created large 'surpluses', which either had to be stored in the EU at considerable cost, or exported as food aid.

Under this system EU agricultural products would regularly be exported at highly subsidised prices to African markets, often in ways which *disrupted local production or held back the development of local production*. While this might benefit traders, processors (most notably in Mauritius) and occasionally consumers, the production effects in what are largely agrarian economies commonly outweighed these temporary consumer benefits.

However, the large EU stocks of basic agricultural products did serve to *curb speculative pressures in global agricultural commodity markets* – an influence which was sorely missed during the 2007-08 global price surges, when EU public intervention stocks had been systematically run down.²

At the same time the old system brought significant advantages to certain African producers, through the preferential access granted to the high-priced EU market for certain agricultural products under the Lomé Convention. This arrangement, by waiving the high import duties, often on quota-restricted volumes, enabled some African producers to benefit considerably from the high EU agricultural prices. The greatest benefits were gained by certain African sugar exporters who commonly secured incomes of over €250 million more than would have been available on the world market (over €500 million during the 1999+/2000 season when world prices were severely depressed). Significant income gains also accrued to African banana and beef exporters under the commodity protocols and to African fruit and vegetable exporters under declaration XXII of the Fourth Lomé Convention.

The shift to income support through direct aid payments to farmers has allowed the EU to lower its administratively determined agricultural product prices. This allowed cereal prices to fall by around 50%, with direct aid payments coming to account for between 57% and 70% of EU cereal farmers' incomes.

While under the CAP reform process EU farmers have largely been insulated from the income effects of price reductions, African exporters simply had to carry the income loss. This *has served to significantly erode the value of traditional African trade preferences*. In recent years this has been most noticeable in the sugar sector, where by October 2009

the prices paid for African raw sugar exports will have been reduced by a minimum of 36% compared to 2005 price levels. This represents a loss of €189 per tonne on sugar exported to the EU.³

Since 1992 a similar process has been occurring in the case of other major temperate agricultural products (and bananas) exported by sub-Saharan African (SSA) countries to the EU, with the beef, rice, cotton, fruit and vegetable, and even the banana sector being affected as the process of CAP reform has been rolled out to more and more products. *In some sectors this process of price reductions has driven some African exporters out of the EU market*. For these African exporters, the removal of EU quantitative restrictions on exports, which the EU internal reform process has allowed, will bring little or no benefits. For African producers of low-cost items, however, the new market opportunities emerging in the EU are at much lower average prices, which are tending towards equivalence with world market prices. For African producers of high-quality/high-value products, stronger price trends combined with the new market opportunities potentially create real possibilities for production expansion, if market entry standards (such as increasingly strict food safety standards) can be met.

A second consequence of the shift to direct income support payments has been an increase in the export price competitiveness of basic EU food and agricultural exports. The shift to income support has allowed administratively determined agricultural prices to be brought closer to world market price levels, without undermining farm incomes and hence overall production levels in the EU.⁴ This has made certain EU food and agricultural products, notably wheaten products and poultry meat, much more price-competitive on African markets. This has led to a rapid expansion of EU exports of these products to certain target markets in Africa. In certain sectors this situation has been compounded by increased competition from advanced developing country suppliers on traditional EU export markets. This competition has then forced EU exporters to fall back on African markets as 'markets of last resort'. On occasion this has served to disrupt individual African markets and undermine domestic production. EU exports of value-added food products have also grown rapidly.⁵

At the all-ACP level the agricultural trade surplus with the EU shrank 28.2% between 1999 and 2006, with the value of EU food and agricultural exports growing 38.9% while the value of ACP exports stagnated.⁶

2. In 2004 total cereals stocks held amounted to 17.4 million tonnes; by 2007 this had been reduced to 0.3 million tonnes. Similarly, following EU rice sector reform, paddy rice stock held in intervention stores fell from 600,000 tonnes to zero.

3. Under current circumstances these guaranteed EU sugar prices are still above world market prices. However, this can change, depending on the world market price for sugar (closely linked to the oil price trend), the Euro-US dollar exchange rate and the evolution of freight charges (since EU prices are c.i.f. prices and world market prices are f.o.b. prices).

4. At the same time it has fostered a significant redistribution of production of individual commodities across EU member states and allowed less productive land to be taken out of production and be dedicated to environmental measures.

5. More details on the impact on trade in value-added cereal products can be found in the agritrade executive brief on the cereals sector at: <http://agritrade.cta.int/en/Commodities/Cereals-sector/Executive-brief>. Details of the expansion of exports of poultry parts to West Africa can be found in the agritrade brief on CAP reform at: <http://agritrade.cta.int/en/Key-topics/CAP-reform/Executive-brief>

6. For details see DG Agriculture's statistics at the following weblinks for EU exports and imports respectively:

From Quantity to Quality

As CAP reform gained momentum, a further fundamental policy shift emerged: *a gradual shift in policy emphasis from the quantity of production to the quality of production*. Initially this policy shift appeared to be driven by food safety concerns, following a number of high-profile food safety scares and the dioxin scandal in Belgium. However, more fundamentally it has been driven by changing patterns of European food consumption.

As individual Europeans become more affluent, the tendency is not towards eating more but eating differently. This has led to the emergence of two distinct components of the EU market: *'necessity purchases'* and *'luxury purchases'*. 'Necessity purchase' decisions are made by consumers entirely on the basis of price. 'Luxury purchase' decisions are made by consumers primarily on the basis of quality or ethical considerations rather than price. Significantly, these two market components are now subject to divergent price trends. Demographic trends suggest the 'necessity purchase' component will stagnate and face declining prices, while trends in income growth suggest the 'luxury purchase' component will grow strongly and enjoy buoyant price trends.

Against this background the current aim of EU agricultural and rural development policy is to shift EU food and agricultural production towards serving 'luxury purchase' markets in the EU and globally. EU policy on geographical designations of origin, geographical indicators and quality labelling more generally, is closely linked to this underlying policy objective.

Ultimately, across the EU the agricultural sector will either be price-competitive with globally sourced products and will feed into the EU value-added food products sector or will be serving luxury purchase components of the market. Any other form of production will have been phased out. *This policy direction is creating space for increasingly liberalised import regimes for basic agricultural products*, which feed into globally competitive EU value-added food product industries or directly serve the 'necessity purchase' component of the EU market. *However, this increased market access will be on the basis of much lower prices than preferred ACP exporters have traditionally enjoyed.*

In support of this policy the EU has substantially expanded the scope and funding of its rural development policy and programmes. Under axis 1 from 2007 to 2013 some €53 billion in public aid will be provided to 'pump prime' programmes to enhance the competitiveness of EU food and agricultural sector enterprises serving higher-value, higher-quality markets. In addition, as an integral part of this rural development policy the EU is seeking to broaden out employment opportunities in EU rural areas, such that the food and agricultural sector is a progressively diminishing source of income in rural areas. In support of these broader purposes over €100 billion in additional public aid is to be deployed over the 2007-13 period under EU rural development programmes.

This shift from quantity to quality has a number of significant implications for SSA food and agricultural sectors. The first effect relates to the increasingly strict food standards applied to products placed on the EU market. This has a number of dimensions. The most immediate effect is on the food safety and special products standards which need to be met, and verifiably enforced, for access to be allowed to the EU market. The investments required to meet these standards can significantly increase the costs of producing for export to the EU. Since these cost-increasing effects tend to be 'bulky', exporters with limited production runs can find the high unit cost of compliance effectively squeezes them out of the EU market. This is particularly the case as EU prices of basic agricultural commodities fall in response to the reforms initiated. These stricter food safety and SPS standards can also place expensive new financial burdens on the public purse, as responsibility for verifying the safety of food produced for export to the EU is increasingly laid at the door of publicly funded bodies in African countries. Here again, where export volumes are limited the costs can become prohibitive.

The gradual shift to a greater emphasis on agricultural product quality has seen the emergence of private voluntary standards (PVS). These too can place significant additional financial burdens on ACP producers. This poses particular challenges where PVS becomes the industry norm for imports into the EU. In these instances *the choice is between compliance, regardless of the costs, or the abandonment of exports to the EU.*

The proliferation of PVS and the emergence of growing price differentials between different components of the EU market, based on quality considerations, are making profitably serving the EU market an increasingly complex exercise. In major export sectors this is leading to a review of African corporate strategies, with new strategic alliances being built with EU companies that understand more fully these market trends.⁷

Ironically, the shift to quality production is progressively opening up the EU market to African food and agricultural exports. The clearest illustration of this is the full duty free/quota free access granted to LDCs and African countries whose governments have initialled interim EPAs. However while this is opening up export opportunities for some African countries in some sectors, the dominant trend is that while the EU market for African food and agricultural exports is becoming *more open* (through the complete abolition of import duties) it is also becoming *less accessible*, as stricter food safety and higher quality standards increase the costs of serving the EU market. Just how accessible the now fully opened EU food and agricultural markets are to African exports will depend crucially on how the income from

7. This coincides in some sectors (such as sugar) with EU companies 'going global', as the situation on the EU market is changed by the process of reform. Thus we find that by 2009 the owners of British Sugar, Associated British Foods, had some 70% of its total sugar production outside of the EU, whereas prior to the reform process it was exclusively a processor of EU sugar beet. This overseas production is located primarily in China and southern Africa. Investments in China are primarily orientated to serving the domestic Chinese market, while investments in Southern Africa, through the purchase of a 51% stake in the South Africa-based sugar giant Illovo, is primarily aimed at expanding production of sugar for export to the EU market under the new duty free/quota free market access arrangements coming into effect from October 2009.

http://ec.europa.eu/agriculture/agrista/tradestats/2006/eur25ch/page_071.htm

http://ec.europa.eu/agriculture/agrista/tradestats/2006/eur25ch/page_072.htm

higher prices and higher-quality production is distributed along the supply chain.

Conclusion

Overall, the aim of CAP reform is to create a globally orientated, price-competitive value-added food products industry, which increasingly focuses on high-quality/high-value production. This will create space for *increased imports of basic agricultural raw materials*, feeding into EU food-processing industries and directly serving the ‘necessity purchase’ components of the EU market. However, as stated earlier, it is only in sectors where African production costs are globally competitive (such as sugar) that African exporters will be able to benefit.

Across a range of sectors (sugar, bananas, beef, rice, fruit and vegetables) this expanded access for basic agricultural raw materials will be on the basis of *much lower prices than those traditionally enjoyed by sub-Saharan African exporters*. Indeed, EU prices for basic agricultural commodities will *increasingly be aligned with world market prices*. What is more, the *fixed costs of serving EU food and agricultural product market are likely to increase significantly*, as stricter food safety and food quality standards are more rigorously enforced.

This will have important implications for the *distribution* of export-orientated agricultural production both *across sub-Saharan African countries* and between *different modes of agricultural production*, with smallholder production, not directly aligned to larger production units with a clear understanding of EU markets, being increasingly squeezed out of the supply chain.

It will also see *EU competition on African national and regional value-added food product markets increase considerably*. African value-added food product industries may find themselves *restricted to serving only the lower value end of local and regional markets*, with EU exporters increasingly creaming off the higher value end of these markets. This could increasingly *lock African food and agricultural sectors into supplying lower value food and agricultural products to EU, national and regional markets*, while EU enterprises increasingly serve the expanding higher value end of these markets.

This would appear to have serious implications for the *longer-term prospects for the development of a food and agricultural sector in Africa capable of lifting the majority of the rural poor out of poverty*.

This being stated, *different African countries and different sectors will be affected very differently*. Thus we find in the sugar sector expanded access, even at lower prices, bringing major economic gains to low-cost, LDC sugar producers. The International Sugar Organization (ISO) has estimated that by 2014/15 the value of preferential sugar exports to the EU (increasingly from African LDCs) will have expanded by 24% compared to the 2004/05 level, to over €1 billion. This

will occur despite the 36% reduction in the EU price paid ACP suppliers. In contrast, by this time most traditional ACP beef exporters are likely to have been squeezed out of serving the EU market, unless high-value/high-quality markets with much higher financial returns are targeted.

RECOMMENDATIONS

African policy makers should:

- *carefully review the trade concessions they are signing onto in the various interim EPAs* to ensure effective trade policy tools remain available to support food and agricultural sector transformation and development in the emerging era of volatile global food prices;
- *Closely monitor the evolution of the EU's agricultural food product quality policy*, to ensure that no systemic barriers are created to efforts to promote African production of high-quality, high-value products for export to the EU.

EU policy makers should:

- allow African governments to continue to use trade policy tools in support of agricultural and food sector development and should desist from requiring their dismantling within the framework of the EPAs, regardless of the local consequences;
- ensure that the EU's evolving agricultural products quality policy does not systemically disadvantage African exporters seeking to serve ‘luxury purchase’ components of the EU market, but on the contrary enables them to gain the commercial benefits of serving high-quality, high-value markets in the EU;
- provide targeted aid for trade support in meeting all types of food standards and verifying compliance, so as not to drive smaller ACP producers out of the EU market;
- Expand targeted production and trade adjustment and development support to the African food and agricultural sectors, based on the market-led private sector-based approach used under the EU's own axis 1 rural development programmes.

References

CTA Agritrade website

For general information on developments in ACP-EU agricultural trade relations the principal source is the *Agritrade* website of the ‘Technical Centre for Agriculture and Rural Cooperation ACP-EU’ (CTA), Wageningen, The Netherlands: <http://agritrade.cta.int/>

CTA *Agritrade* Executive Brief on the International Dimension of the Reform of the CAP <http://agritrade.cta.int/index.php/en/Key-topics/CAP-reform/Executive-brief>

CTA *Agritrade* Special Report on ‘Contentious issues in IEPA negotiations; implications and questions in the agricultural sector’ <http://agritrade.cta.int/en/Resources/agritrade-documents/Special-reports/Contentious-issues-in-IEPA-negotiations-implications-and-questions-in-the-agricultural-sector>

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