Analytical Note
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EU'S INCREASING USE OF DECOUPLED DOMESTIC SUPPORTS IN AGRICULTURE: IMPLICATIONS FOR DEVELOPING COUNTRIES

SYNOPSIS

The EU has been undertaking reform in its Common Agricultural Policy. Nevertheless, subsidies to EU agricultural producers are continuing. The major change is that 93% of these supports are now provided in the form of direct aid payments to producers. On these grounds, the EU is arguing in the WTO that its supports are no longer trade distorting, since they are not tied to farmers' production. In some sectors such as cereals, these direct payments compensating EU farmers directly have had the effect of drastically reducing domestic prices in the EU, whilst also making these EU subsidised produce 'competitive' on the world market.

These distortions have far-reaching implications for developing countries, including on their small farmers. EU's developing country partners negotiating trade agreements with it should therefore have a range of trade policy tools to protect themselves against EU-created distortions in agricultural trade.

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This Analytical Note is written by Paul Goodison in collaboration with the Trade for Development Programme (TDP) of the South Centre to contribute to empower the countries of the South with knowledge and tools that would allow them to engage as equals with the North on trade relations and negotiations.

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I. INTRODUCTION

1. In EU Free Trade Agreement (FTA) negotiations, EU has not wanted to deal with agricultural subsidies on the grounds that these negotiations are already taking place at the WTO. This is not a satisfactory argument since the FTAs will cut developing countries' tariffs further than what is demanded in the WTO's Doha Round. In addition, in the Doha negotiations, these EU subsidies are continuing. Only the labels for the subsidies have changed to make them seem innocuous.

2. This paper points out examples of research (including EU's own research) illustrating that Europe's direct aid payments as well as its trade policy tools have trade distorting effects. Without these supports, EU cereal production are projected to decline drastically; the EU would become a net durum wheat importer rather than exporter; beef production would also fall dramatically (more than the present reductions); ethanol production would virtually disappear; and poultry production would also be less competitive.

3. Whilst the paper makes many references to ACP countries, the distortions in trade equally affect many other non-ACP developing countries.

II. EUROPE'S DIRECT AID PAYMENTS IN CONTEXT

4. The most important development under the Common Agricultural Policy (CAP) has been the transition to **decoupled direct aid payments**. Over the period from 2010-13, the EC estimates that some 69% of expenditures will be in the form of direct aid payments which are largely decoupled and 24% in the form of rural development expenditures. Both these forms of assistance are decoupled from the volume of production of individual commodities and hence are classified as 'non-trade distorting', 'green box' measures in the WTO. The EC therefore argues that for the period 2010-13 some 93% of its agricultural support funding will be provided in a non-trade distorting form. This transition is thus designed to insulate EU agriculture and rural development programmes from challenge in the WTO.[1] **Thus not only financially but also in terms of the EU's international relations, the move over to decoupled direct aid payments and expanded rural development spending is the most dominant and significant trend in the deployment of financial policy instruments under the CAP.**

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[1] WTO domestic supports are classified under 'amber' box payments, which are seen to be trade-distorting and had to be disciplined, 'blue' box payments, traditionally housing production limiting programmes, which are seen to also be somewhat trade-distorting, and 'green' box payments, which are supposedly non-trade distorting and for which the WTO imposes no disciplines. Green Box payments can thus be provided without limits. The WTO's Dispute Settlement however, has found in a couple of cases that some of the Green Box payments provided have been trade distorting. Since the Uruguay Round, the Green Box has been, and remains today the major loophole shielding US and EU's agricultural sector from 'liberalisation' in the WTO's Agreement on Agriculture.

Indicative EU budget allocations 2010-2013 (CAP, market management measures and total EU budget) € millions & % share total budget

	2010	2011	2012	2013
Total EU Budget	140,978	142,629	147,210	151,976
'Preservation and management of natural resources' (CAP market management measures, rural development funding, environmental measures, fisheries measures)	59,955 42.53%	60,338 42.30%	60,810 41.31%	61,289 40.33%
…. Of which CAP market management measures	47,146 33.44%	47,617 33.39%	48,093 32.67%	48,574 31.96%

5. While this EC perspective on the non-trade distorting nature of its main instruments of agricultural support is now the official position in terms of the WTO classification of such agricultural support measures, there is nevertheless a growing debate over the impact of such **decoupled direct aid payments** on farmers' production decisions (particularly where these payments can account for up to 70% of total farm income as they have done in the case of cereal farmers) and hence the trade outcomes this generates.

Evolution of the Total CAP Budget and Direct Aid Payments 2000 – 2008 (Million Euro)

	Total CAP Budget	Total Direct Aids	Decoupled direct aid	Other Direct Aid	Add. Direct aid
2000	40,467	25,529 63.1%			
2001	42,083	27,430 65.2%			
2002	43,214	28,801 66.6%			
2003	44,461	29,692 66.8%			
2004	44,761	29,825 66.6%			
2005	48,928	33,701 68.9%			
2006	49,865	34,051 68.3%			
2007*	54,521	37,064 68.0%	30,369 55.7%	6,261	434
2008*	55,081	37,569 68.2%	31,415 57.0%	5,620	534

* Includes EU budget financed rural development expenditures which have been taken out into a separate rural development[2] fund
Source: Table 3.4.4.' Agriculture in the European Union Statistical and Economic Information' series annual report 2000 to 2009

III. THE PRICE EFFECTS OF DIRECT AID PAYMENTS

6. This shift to direct aid payments has allowed administratively determined minimum prices to be lowered without undermining the EU production base. This has brought down market prices in the EU and has served to expand both consumer and industrial demand for these products within the EU. The reduction in prices has also served to close the gap between EU and world market prices, thereby enhancing the ***price competitiveness*** of EU food and agricultural product exports, although this 'competitiveness' can be seen as an artificial one, given the level of direct aid payments required to sustain EU production at current levels in a number of major sectors.

7. In addition, by allowing farmers to choose what to produce from the wide range of products falling under the single payment scheme (the principal form of decoupled payment), this reform is encouraging the relocation of production of specific products to those areas most suited to their competitive production, thereby enhancing the ***underlying competitiveness*** of EU food and agricultural production. Giving farmers greater choice over what to produce within the single payment scheme has also encouraged a more market orientated pattern of production within the European farming sector.

8. The move to decoupled direct aid payments thus makes an important contribution to enhancing both the ***price competitiveness*** and ***underlying competitiveness*** of EU agricultural production. This represents one of the important objectives of the process of CAP reform.

IV. THE DEBATE ON THE IMPACT OF DIRECT AID PAYMENTS

9. The production and trade effects of EU direct aid payments and the impact of certain of the expenditures under the EU's rural development programmes on production and trade patterns are an increasingly contested issue. There can be little

[2] From 2007, as part of an overall review of EU budget classification, rural development expenditures were classified as a separate budget item. This in part reflects an expansion of non-agriculture related rural development expenditures. However, it should be noted that agriculture and food sector related expenditures still constitute a major item under the rural development budget. Taking EU budget allocations and member states co-financing together, some €53 billion is being deployed in support of measures to enhance the competitiveness of EU food and agriculture sector enterprises between 2007 and 2013.
To ensure consistency of treatment of market management and rural development spending from 2000 to 2008, the rural development spending which was budgeted separately from 2007 has been added to the total of CAP related expenditures.

doubt that decoupled payments maintain land in agricultural production in the EU, which would not otherwise be in use. Indeed, preventing land abandonment was an important consideration in setting the levels of direct aid payments and the pace and extent of the decoupling of direct aid payments from the production of specific crops. Maintaining land in agricultural production is thus an explicit objective of such payments.

10. In terms of the overall production effects, the EC argues that '*the absence of agricultural support in the EU would not drastically affect the overall level of production*' but that it would affect '*the territorial and environmental balance of production*'. This begs the question of what would be classified as a 'drastic' effect on production and the scale of the production effects which could occur short of being classified as 'drastic'.

11. In this context it should be noted that in response to radical proposals for the replacement of direct aid payments with social expenditures better targeted at the rural poor, the then Agriculture Commissioner, Marianne Fischer Boel pointed out the consequences of any abolition of direct aid payments under the CAP would be '*a technical insolvency of many farmers because of the importance the support has for farmers' income*'. Some may see this as a rather 'drastic' consequence, the impact on EU production levels and trading activities would likely be quite dramatic.

V. THE DIFFERENT PRODUCTION OUTCOMES OF SCENAR 2020 UPDATE SCENARIOS

12. How significant direct aid payments are in terms of land utilisation and overall levels of EU production was recently illustrated by the update of the EC's own scenarios of the different CAP reform directions and their outcome - the 'Scenar 2020' study[3]. The different scenarios for the future of the CAP, included a full '**liberalisation scenario'** which assumed '*all agricultural trade related measures are discontinued, the CAP budget is reduced by 75% in real terms, all direct payments and market instruments are removed*'. The differences between the production outcomes and price situations under the 'liberalisation scenario' and the 'reference scenario[4]' suggest that current EU policy measures have a significant effect in terms of maintaining EU production at higher levels than would be the case in the absence of such policy measures.

13. The study found that in terms of crop production under all scenarios, '*there is an increase in production*' as a result of '*yield increases*'. Under the reference scenario, cereals

[3]See ECNC/LEI/ZALF, final report for 'the update of analysis of prospects in the Scenar 2020 study: preparing for change', contract no. 30-CE-0200286/00-21 (full text), December 2009 at http://ec.europa.eu/agriculture/analysis/external/scenar2020ii/report_en.pdf and ECNC/LEI/ZALF, executive summary of Scenar 2020 study: update, December 2009 at http://ec.europa.eu/agriculture/analysis/external/scenar2020ii/summary_en.pdf

[4] The 'reference scenario assumes 'the implementation of a Single Payment System as of 2013, full decoupling, a 30% decrease in direct payments in nominal terms and a 105% increase of the European Agricultural Fund for Rural Development (EAFRD)', with external trade arrangement being founded on a WTO settlement 'based on the December 2008 Falconer paper'. The 'liberalisation scenario' assumes that all agricultural trade related measures are discontinued, 'the CAP budget is reduced by 75% in real terms, all direct payments and market instruments are removed, and there is a 100% increase of EAFRD'.

production is projected to increase almost 13% between 2005 and 2020 (equivalent to 36 million tons), with wheat growing 16% (+22 million tons) and the growth in coarse grains being driven by biofuel policies. Production growth is driven by technical progress increasing yields. **In contrast, relative to the reference scenario, cereal production declines under the 'liberalisation scenario'**, '*mainly because of the withdrawal of decoupled payments … and the complete reduction of trade policy measures*'.

14. In the oilseeds sector, production increases 20% under the '**reference scenario**' as a result of technical progress, while under the '**liberalisation scenario**' the increase is slightly lower.

15. In the livestock sector '*under the '**reference scenario**', beef production at EU27 level declines by 10%*', however beef consumption remains broadly constant. Overall meat consumption in the EU27 increases 10% per capita, with pork and poultry producers being the beneficiaries. Under the '**liberalisation scenario**', '*declining prices lead to a strong decline in beef production in all EU member states*', with production declining by more than 30%. However, lower prices under this scenario stimulate beef consumption. Production of poultry and pork is projected to increase under the '**reference scenario**' (+13% and +5% respectively). However with consumption of poultry and pork growing even faster, imports increase under the '**reference scenario**'. In contrast, under the '**liberalisation scenario**' a reduction in pork and poultry meat production relative to levels under the '**reference scenario**' takes place (poultry -7% and pork -3% compared to the reference scenario level), although there is still an increase over 2005 levels. Under the '**liberalisation scenario**', however, consumption of pork and poultry meat shrinks as more beef is consumed.

16. In the dairy sector under the '**reference scenario**' the composition of EU dairy production shifts: cheese production is projected to increase by over 18%, while butter and milk powder production is projected to decline 8% and 3% respectively. Production of other dairy products increases by some 15%. Under the full '**liberalisation scenario**' EU27 cheese production increases even more than under the reference scenario.

17. In terms of biofuels under the '**reference scenario**' production is projected '*to increase from 3.4 million tonnes in 2005 to 12.1 million-tonnes oil equivalent in 2020*', on the basis of an assumed blending rate of 7% and changes of tariffs on imports of biofuel. EU27 demand for biofuel increases to 30.1 million tonnes, increasing imports. Under the '**liberalisation scenario**' ethanol production in the EU would virtually disappear (i.e. it is uncompetitive at world market prices without public assistance) and bio-diesel production would be lower than under the '**reference scenario**'.

18. Land use is greatly affected by the scope of liberalisation, with biofuels policy also having a major impact in the crop sector.

The table below sets out the projected price changes under the reference scenario and the liberalisation scenario.

Projected changes in producer prices in EU27 under different scenarios

	'Reference scenario' 2004/05 to 2020 Price changes as a percentage (%)	**'Liberalisation scenario' relative to 'reference scenario' by 2020 Price changes as a percentage (%)**
Soft wheat	-8.9	-7.8
Barley	-14.7	-9.8
Corn	-6.5	-3.4
Rice	-25.8	-18.3
Sugar	-12.9	-7.1
Soybean	+4.9	-5.0
Rapeseed	+5.8	-7.0
Sunflower seed	+1.0	-9.3
Milk	-21.4	-1.3
Beef	-15.4	-33.4
Sheep	-19.9	-16.5
Pork	+1.3	-3.1
Poultry	+3.1	-5.4
Eggs	+13.6	-1.3

Source: ESIM results. Note: The price changes in the '**liberalisation scenario**' are **additional** to any price reductions which may occur under the '**reference scenario**'. That is, total price changes for e.g. soft wheat under the 'liberalisation scenario' comes to -16.7%.

19. Overall price changes under the '**liberalisation scenario**' are more pronounced than under the reference scenario, since this assumes that '*all remaining support as well as restrictive measures are withdrawn, both within domestic markets (subsidies, direct payments, quotas and set-aside requirements) as well as at the border (import tariffs and tariff-rate quotas)*'. Thus the '**liberalisation scenario**' would undermine income and employment most in the EU food and agricultural sector, with this being an important consideration in some EU member states. Overall, the study concludes '*the process of liberalisation has a greater impact on agricultural income than on agricultural production and land use*'.

20. In terms of the overall trade effects the study concludes that while '*the amount of agricultural products imported into the EU is related to the degree of border protection*', imports overall are '*set to increase under the provisions of the Falconer proposal*'. Under the '**liberalisation scenario**', EU exports are also set to increase, '*but to a lesser extent than imports*'.

21. This study suggests significant production and trade effects if current EU agricultural support measures are dismantled (including the direct aid payment scheme, but also the multiplicity of other policy tools used, including trade policy tools). This suggests that their continued use also has significant production and trade effects.

VI. THE CASE OF EU DURUM WHEAT PRODUCTION

22. The fact that current payment systems sustain production levels in certain sectors was confirmed by the recent evaluation of the EU regime for the durum wheat sector[5]. This evaluation concluded that in the absence of direct aid payments, the area under durum wheat would fall by a further 18% if prices reverted back to 2006 levels or 4% if prices and costs stayed at 2008 levels (when world market prices were at exceptionally high levels). In 2008, the EU exported some 20% of its durum wheat production. This however was an exceptional year. In the coming years the EC projects that exports would be around 10% of EU durum wheat production. Thus, if the Landell Mills Consulting (LMC) projections of the effects of the withdrawal of direct aid payments in the durum wheat sector are accurate, this suggests that in the context of prices around 2006 levels, the withdrawal of direct aid payments in the durum wheat sector would transform the EU from a net exporter to a net importer of durum wheat. This illustrates the trade consequences of the production effects of the EU system of direct aid payments.

EU Durum Wheat Production and Exports, EC Projections 2008-2015 (million tonnes)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
Production	8.2	10.0	8.9	8.8	8.9	8.8	8.8	8.8	8.8
Exports	2.1	2.0	0.9	0.9	0.9	0.9	0.9	0.9	0.9

Source: 'Prospects for Agricultural Markets and Income in the European Union 2008-5015', EC, March 2009

VII. THE COMPLEXITIES OF WIDER CONSIDERATIONS IN THE CEREALS SECTOR

23. In the cereals sector it can be argued that the higher EU production levels sustained by the use of existing EU policy tools (notably decoupled direct aid payments), helps lower global cereals prices to the benefit of consumers in net-food-importing developing countries. This would appear to be a positive development for the ACP, since patterns of EU exports of cereals appear to have minimal impacts on ACP cereals production.

24. Yet this neglects the growing volume of EU exports of processed cereal products to African markets, arising from the availability of domestically produced EU cereals at prices which are up to 50% below the EU cereal price levels which prevailed prior to the initiation of reform in 1992[6]. This export trade to African markets has been growing

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[5] LMC International, full text of EC evaluation of durum wheat sector, November 2009 at http://ec.europa.eu/agriculture/eval/reports/wheat/fulltext_en.pdf and LMC International, executive summary of EC evaluation of durum wheat sector, November 2009 at http://ec.europa.eu/agriculture/eval/reports/wheat/exec_sum_en.pdf

[6] These reforms essentially involved a shift from price support for EU cereals to the provision of direct aid payments to EU cereal farmers. These direct aid payments initially took the form of production related payments, then subsequently area related payments and eventually

as EU exporters have been squeezed out of North African and Middle Eastern markets and could potentially undermine local cereal-based value-added food product industries[7]. Thus we find that between 1996 and 2006,[8] the share of 'preparations of cereals' destined for ACP markets (mainly in West Africa) doubled from one in twenty tonnes exported to one in ten tonnes exported, with EU exports to the ACP increasing more than three-fold. This compares to an increase in the value of EU exports of only 67%. For the category of 'products of the milling industry', EU exports to the ACP doubled in value terms between 1996 and 2006, while EU global exports stagnated. This increased the importance of the ACP market to EU exporters from 12.6% to 25.4% in the case of 'products of the milling industry', and from 4.9% to 10.4% in the case of 'preparations of cereals'.

EU cereal product exports to ACP countries 1996-2004, million ecu/euro

	Preparations of cereals ACP (CN[9] 19)	Preparations of cereals World (CN 19)	EU exports to ACP countries as % of total exports
1996	133	2,724	4.9
1997	176	3,021	5.8
1998	226	2,947	7.7
1999	230	2,829	8.1
2000	281	3,242	8.7
2001	368	3,700	9.9
2002	350	3,666	9.5
2003	339	3,569	9.5
2004	359	3,374	10.6
2005	385	3,689	10.4
2006	420	4,055	10.4

Source: 'The agricultural situation in the European Union' annual reports, Tables 3.7.2 and 3.7.12.

decoupled farm payments. However throughout this process of reform, certain coupled payments have been retained in the cereals sector.

[7] EU cereal based food products have been squeezed out of Middle Eastern and North African markets by two developments. The first is the trend towards the establishment of local mills, to process imported grains in line with local tastes. The second, is the emergence of the new Black Sea cereal exporters (which until the recent adverse weather events accounted for 30% of the global wheat trade up from 5% ten years ago). These suppliers enjoy freight cost advantages on middle eastern markets and are also price competitive on North African markets where the Euro is strong. These advantages are less pronounced on West African markets, where currency links also aid EU exports.

[8] The use of this reference period factors out the surge in global cereal prices from the underlying trend.

[9] CN – Combined Nomenclature

EU cereal product exports to ACP countries 1996-2004, million ecu/euro

	Products of the milling industry ACP (CN 11)	Products of the milling industry World (CN 11)	EU exports to ACP countries as %age of total exports
1996	201	1,597	12.6
1997	333	1,978	16.8
1998	361	1,639	22.0
1999	302	1,398	21.6
2000	343	1,598	21.5
2001	336	1,749	19.2
2002	368	1,787	20.6
2003	340	1,696	20.0
2004	362	1,764	20.5
2005	368	1,536	24.0
2006	404	1,592	25.4

Source: Extracted from 'The agricultural situation in the European Union' annual reports, Tables 3.7.2 and 3.7.12.

25. These trends need to be seen against the background of the growing competitive threat which the EU faces on traditional markets for its cereal product exports. This intensified competition appears to have a direct bearing on the Economic Partnership Agreement (EPA) negotiation process.

26. According to a presentation by a representative of EU wheat flour exporters at the DG Agriculture-organised symposium on EU agri-food export interests in free trade negotiations, held on June 25th 2007, the ACP is now taking '*over half of all exports*[10]'. In this context the high tariffs applied on flour imports into ACP markets (sometimes up to 50% duties) were highlighted. Industry representatives went on to call for EU export interests to be fully taken into account in the ongoing EPA negotiations and for the EC to provide '*active support for the position of the EU flour exporters*' in the EPA negotiations.

27. Thus we find that with EU wheat flour exporters coming under pressure in other more lucrative markets, there has been a tendency to fall back on supplying markets in West Africa and there has been increased pressure on the EC to secure the removal of both tariff and non-tariff barriers to EU cereal product exports.

28. However, the implementation of provisions under the Interim Economic Partnership Agreements (IEPAs) dealing with ACP countries' non-tariff and tariff barriers to EU cereal product exports could potentially close off opportunities for attracting investments in ACP countries for new milling capacity. Such new capacity

[10] See presentation by J. Rossy, Presidnet of Euroflour at:
http://ec.europa.eu/agriculture/events/foodexport2007/coceral_euromalt_en.pdf
Speeches made at the symposium can be accessed at:
http://ec.europa.eu/agriculture/events/foodexport2007/index_en.htm

could potentially serve emerging regional markets across the ACP (in particular in West Africa to Southern Africa). Thus we find these non-tariff provisions of a number of EPAs have become a bone of contention in what is now an endless process of EPA negotiations. This is due to the conflict between the commercial interests of EU companies and the keen interest of ACP governments to promote an expansion of cereals production (or local cereals processing) in the face of increasingly volatile global food prices, and the trend of rising global cereal prices.

29. These trends will have a greater impact on ACP countries in the coming years, should there be a strengthening of the US dollar against the euro, since this would greatly increase the price competitiveness of European wheat, barley and maize. This could enable EU suppliers to win contracts and supply markets which ACP country producers and processors previously served. In this context, the fact that the new EU system of direct-aid payments is judged, at the macro-economic level, to be less trade-distorting than other forms of public aid, will provide little consolation to ACP producers who will find their markets undercut by the 'more competitive' EU exports.

30. Whether or not the ACP governments will in turn be able to use traditional trade policy tools (tariffs, quotas, export restrictions etc) will have an important bearing on the overall impact of the EU's shift to increased direct aid payments in the processed cereals sector and other value-added food product sectors.

VIII. THE CROSS SECTOR EFFECTS OF DIRECT AID PAYMENTS

31. In addition in the cereals sector, there have been important cross-sector effects of the shift to direct aid payments. The average 50% reduction in EU cereal prices since the initiation of reforms in 1992 has greatly enhanced the competitiveness of the EU livestock sector since EU-produced animal feed constitutes a major component of the costs of production (most notably the poultry sector).

32. Thus we find that between 1992 and the end of the decade, EU poultry-meat exports expanded from 400,000 tonnes to 1,000,000 tonnes. Despite growing competition from advanced developing country suppliers, with enlargement to an EU of 25 in May 2005, total EU poultry-meat exports have remained between 786,000 and 877,000 tonnes. However in the coming period EU poultry-meat exports are expected to fall back to an average of around 767,000 tonnes, reaching a low of 758,000 tonnes in 2015 in the face of higher feed costs and intensifying competition.

33. Despite these recent trends, EU programmes of direct aid to farmers in the cereals sector have undoubtedly had a major bearing on the competitiveness of EU production in the poultry sector (and to a lesser extent pig-meat and beef sectors). The contribution made by publicly financed agricultural-support programmes is not apparent from any consideration of EU expenditures in the poultry sector itself. Indeed, no direct-aid payments are made to the poultry sector. The only CAP expenditures listed as being made in the poultry sector are on export refunds for poultry meat and eggs, and these have fallen dramatically since 1991 (from 273 million ecu in 1991 to €110.5 million in 1999 and to a low of €80.6 million for the combined poultry and pig-meat sector in 2006).

34. Two other important factors in the European market have contributed to the expansion of EU poultry exports. These are the growing consumption of chicken breast and reduced consumer demand for chicken parts, and the ban on the feeding of meat and bone meal to ruminants. This effectively removed a substantial domestic market for chicken parts within the EU. This has seen the composition of EU poultry exports change significantly, with chicken parts now accounting for around 60% of total poultry meat exports. This expansion of chicken part exports has largely been directed towards ACP markets.

35. These developments saw a surge in EU exports of poultry parts to West African markets, to the detriment of local poultry producers in the countries targeted by EU exporters.

36. Looking beyond the poultry sector, a consideration of EU-ACP trade statistics reveals that between 1996 and 2002, EU exports of meat products[11] to ACP countries increased in value terms by 121%, before falling back in 2006 to a level only double above the 1996 level (following a partial recovery of the EU position in former markets affected by food safety and animal disease control scares). This nevertheless represents a 65% increase in the importance of ACP markets to EU meat exporters.

37. It should be noted that this expansion occurred despite the BSE and foot-and-mouth disease crisis which affected the EU beef sector, and the dioxin and avian flu crisis which affected the poultry sector. This suggests that once again African markets become 'markets of last resort' when a periodic crisis afflicts EU's agricultural sectors.

EU meat product exports to ACP countries 1996-2004, million ecu/euro

	Meat ACP (CN 02)	**Meat World (CN 02)**	**EU exports to ACP countries as % of total exports**
1996	115	3,275	3.5
1997	150	3,644	4.1
1998	186	3,285	5.7
1999	188	3,743	5.0
2000	223	3,943	5.7
2001	240	3,830	6.3
2002	255	3,689	6.9
2003	247	3,156	7.8
2004	238	3,709	6.4
2005	210	3,823	5.5
2006	230	3,994	5.8

Source: Figures are extracted from the various annual report 'The agricultural situation in the European Union' for the period covering 1996 to 2006 Tables 3.7.2 and 3.7.12.

[11] Meat includes, poultry, beef and pork.

IX. THE EPA DIMENSION

38. Significantly the impact of the production and trade 'knock-on effects of EU direct aid payments on individual ACP countries is likely to be strongly affected by the commitments on non-tariff issues entered into by ACP governments through the economic partnership agreements currently being concluded and signed.

39. A recent analysis of the impact of the interim EPAs on food security by Alan Mathews of Trinity College Dublin[12], noted ACP governments '*have made use of their flexibility to exempt many food staples from liberalisation*', but that '*EPA provisions on other border measures are more problematic*'. It noted that the EPAs require '*ACP signatories to make commitments which go beyond WTO disciplines*', with the commitments of most concern from a food security perspective being those related to: tariff standstill commitments; a ban on export restrictions; restrictions on the use of export taxes including in some case prohibitions; limitations on safeguard remedies and inadequate provisions to address the effects of EU export subsidies. The paper called for the removal from the agreement of those interim EPA provisions which '*might potentially limit the policy measures which ACP governments could take to improve food security*', particularly where these go beyond WTO requirements.

40. What these issues mean in practice can be seen from the recent debates around poultry sector policies in West Africa (see box). However it is unclear to what extent the current problematic trade involves exports of EU produced poultry parts, re-exports by EU companies of Brazilian poultry parts or the direct export of poultry parts from Brazil by either EU or Brazilian companies[13].

Divergent Policy Response in the West African Poultry Sector

In recent years divergent policy responses to the challenge posed by the import of low priced poultry parts into West Africa have emerged. In Cote d'Ivoire between 1997 and 2003, while poultry imports grew from 1,815 tonnes to 17,226 tonne, local poultry production fell by a third, with 1,500 producers going out of business and 15,000 jobs being lost. However 'in 2005 the Ivorian government imposed a new tax on imported poultry by-products'. This roughly doubled the price of imported poultry products. With this trade measure in place the President of IPRAVI , the Ivorian poultry producers association, Philippe Ackah claimed Ivorian poultry producers had 'been able to hold our own against fierce competition from imports'. What is more he pointed out that 'this policy didn't cause the slightest shortage or price hike in the cost of chicken or eggs on the national market'.

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[12] See, Institute for International Integration Studies, Economic Partnership Agreements and Food Security IIIS Discussion Paper No. 319, March 2010, at: http://www.tcd.ie/iiis/documents/discussion/pdfs/iiisdp319.pdf

[13] There have been press reports that Irish companies have positioned themselves to play a role in the triangular beef trade in the face of the dramatic reduction in the overall volume of EU beef exports.

According to press reports this policy change not only benefitted poultry producers ,with substantial new investment taking place, but also benefitted local feed suppliers. Overall between 2005 and 2009 Ivorian poultry production expanded from 9,000 tonnes to 20,000 tonnes while egg production expanded from 435 million to 800 million, 'with approximately 39,000 new jobs created'. In January 2010 the Ivorian government committed itself to 'maintain the import duties'. According to Alain Bouabre, an Abidjan based economist 'this regulation saved the Ivorian poultry industry from ruin'. However the local poultry industry now needs to 'get better organised to truly benefit from the situation', since it is 'simply a matter of time before importers find a way around the policy and regain a footing on the market'.

In contrast in Ghana where 'annual imports of subsidised dressed poultry had risen from approximately 42,000 tonnes in 2005 to an estimated 130,000 tonnes in 2009', calls by poultry farmers for government action to 'end the importation of chicken meat', which is undermining local production and threatening the collapse of the local poultry sector, have been met by a marked reluctance on the part of the government to introduce similar measures to those adopted in Cote d'Ivoire. Government trade officials have argued such a course of action 'might be flouting the World Trade Organisation rules'. As a consequence the Ghanaian government is looking for other measures which can be adopted to help local poultry producers 'survive in the open market competition'.

As is apparent from these two examples, West African governments have adopted divergent views on the use of trade policy tools in the face of disruption of local poultry markets. It appears as if in some countries the generalised pressure to abandon the use of trade policy tools in favour of financial support instruments, or simply leaving everything to the free market, is leading to policies which largely abandon local producers to the vagaries of market forces in a sector where development is largely being driven by what is a residual market component of no commercial interest in developed economies (e.g. the market for poultry parts).

Against this background two points should be borne in mind in the context of EU-ACP trade relations. Firstly, OECD economies such as the EU are only abandoning the use of trade policy measures when alternative policy tools to sustain domestic production are firmly in place. In the interim, managed trade remains a feature of the EU agricultural trade regime. Secondly, the scope for most ACP governments to establish financial support mechanisms is limited. Put simply, most ACP governments lack the financial means to finance farmer support measures comparable to those deployed by the EU.

Sources: *ThePoultrySite News Desk,* 'Government puts Ivorian industry on road to recovery', 17 February 2010
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ThePoultrySite News Desk, 'Cheap imports damaging Ghana's poultry industry', 2 August 2010.
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http://www.thepoultrysite.com/poultrynews/20440/govt-urged-to-give-industry-more-support
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X. DIRECT AID PAYMENTS AND THE SUGAR SECTOR

41. In the EU sugar sector direct aid payments would appear to have sustained a higher area under sugar beet than would have been the case in the absence of such payments. Following a series of good harvests, this has given rise to a substantial volume (24% in 2009) of out-of-quota sugar beet production. The 27 January 2010 EU decision to export an additional 500,000 tonnes of out-of-quota sugar proved highly controversial, since it was followed by a sharp slump in world market sugar prices (a 32% decline in raw sugar prices and 26% decline in white sugar prices between 1 February and mid March[14]). This, it can be argued, has served to reduce substantially the earnings on ACP sugar sold at world market prices. A development which in turn could influence commercial contract negotiations with EU importers in the coming period. However the disposal of this sugar could equally have served to reduce downward pressure on domestic EU sugar prices, which could bring benefits to ACP sugar exporters operating under new profit sharing arrangements, which provide for a sharing of profits on white sugar sales in the EU produced from imported ACP raw sugar or ACP refined sugar directly marketed by the EU partner.

42. With regard to ACP-EU sugar sector relations, the global expansion of EU sugar beet companies in the context of the movement away from guaranteed minimum prices for ACP raw sugar exports is raising important questions related to the functioning of the supply, which has direct parallels with recent internal EU deliberations around the functioning of the EU dairy supply chain. In its initial review, the EC recognised that asymmetries in bargaining power along supply chains could give rise to unfair contractual practices and abuses. The EC has therefore been looking at how to regulate the functioning of certain supply chains (i.e. the internal EU dairy supply chains), by promoting greater transparency in contractual arrangements.

43. This would appear to be of particular relevance for future ACP-EU sugar sector relations. Currently, certain supply chains are operating where a parent EU sugar company, has joint venture arrangements to produce and mill sugar in ACP countries. A subsidiary of the parent company has then established a joint venture arrangement with a company which is 51% owned by the parent company, to import into the EU and trade internationally ACP produced raw sugar. This sugar is then being sold to a further subsidiary of the parent company for refining and marketing in the EU. In this

[14] With subsequent deeper price declines before a modest recovery in prices.

context, contractual relationships, and the final price paid to ACP sugar cane growers, can be somewhat less than transparent, leaving scope for abuse of the asymmetries in bargaining power along the supply chain.

XI. Overall Observations

44. The situation with regard to the impact of direct aid payments on production and trade outcomes is not only complex in terms of the effects on different sectors but also in terms of the effects within sectors, depending on the markets served by ACP and other developing countries' producers and the contractual arrangements they have set in place and the trade policy tools which developing country governments retain the right to use as part of their wider agricultural development policies.

45. The effects of decoupled direct aid payments on EU farmers' land utilisation and production decisions and the impact this has on ACP and developing countries' consumers and markets served by local producers need to be assessed sector by sector and country by country. This is because the structure of production, patterns of trade, trade policy tools used, commercial arrangements in place and patterns of consumer demand are different in each situation. The overall impact of the EU direct aid payment scheme will therefore have different ramifications.

46. What is clear is that, given the price reducing effects in the EU of the shift over to direct aid payments and with direct aid payments being some 35 times larger than the financial allocation to EU export subsidies, the impact of direct aid payments on production and trade outcomes is now a critical issue of policy concern. A number of EU farmers would exit cereals production in the absence of direct aid payments. However the precise effects of such a policy change on overall production in developing countries' individual sectors and sub-sectors would be critically influenced by world market price trends. Thus we find in some sectors such as durum wheat production, removal of these supports would likely lead to the EU becoming a net importer rather than a net exporter under the most likely projected price scenarios. The EC however argues that overall EU agricultural production would be only marginally affected.

47. There can be no doubt that EU direct aid payments, the deployment of a multiplicity of other agricultural policy tools and the introduction and adaptation of a range of other EU policies (from energy policy to environmental and climate change related policy initiatives), will have an impact on developing countries producers and consumers, through their various production and trade effects. This is despite the shift over to nominally less trade distorting forms of agricultural support.

48. A major challenge for developing country governments is tracing the impact of these various EU policies, so as to be able to insulate their producers and consumers from the adverse effects of the production and trade effects of these EU policies. However, this task is extremely complex as the impact differs commodity by commodity, and situation by situation. In light of this challenge, it would appear to be vital that developing country governments retain the right to

- on the one hand, insulate their own producers from the worst effects of rapid price declines which could undermine the production base (an objective which at the policy level the EU shares with regard to its own EU agricultural production) and

- on the other hand, insulate consumers from the worst effects of rapid price rises, so as to enhance national and regional food security.

49. This suggests ACP and other developing country governments should not entirely dismantle traditional trade policy tools, but rather should retain the right to use such policy tools in a transparent manner to pursue wider national development and food security objectives. This would be entirely consistent with the EU's own practice under its long-term programme for CAP reform.

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