EXECUTIVE SUMMARY

Impact of Trade Liberalization on Agriculture in the Near East and North Africa
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Executive summary

The "Impact of Trade Liberalization on Agriculture in the Near East and North Africa" provides detailed analysis of both positive and adverse effects of trade liberalization on agriculture in the Near East and North Africa (NENA). Jointly published by the International Fund for Agricultural Development (IFAD) and the International Food Policy Research Institute (IFPRI) in 2007, the report provides key findings requiring the attention of national governments and the international community. It identifies measures to mitigate the negative impact of trade liberalization on small rural producers and outlines steps to help them seize new market opportunities.

The report examines various aspects of agricultural trade liberalization and their impact on small-scale farmers. In particular, it aims to:

- examine current agricultural trade policies in the NENA region;
- evaluate the degree of agricultural liberalization likely to occur as part of various trade agreements;
- analyse the impact of further trade liberalization on small farmers and other poor households; and
- explore policy options for mitigating the negative effects of agricultural trade liberalization.

The study focuses on 13 countries and territories in the region: Algeria, Djibouti, Egypt, Jordan, Lebanon, Morocco, Somalia, the Sudan, Syria, Tunisia, Turkey, the West Bank and Gaza, and Yemen. The report refers to these countries and territories as the 13 NENA countries.

Background
Most of the 13 NENA countries are semi-arid, with limited water and arable land per capita, making agricultural production highly dependent on rainfall. The overall population density of the region is low compared to other developing areas, though it is more urbanized than the average for developing countries. The economic performance of many of the 13 NENA countries has been relatively weak, partially due to instability and various conflicts. These include the Arab-Israeli conflict, the Sudanese civil war, the insurgency in Algeria, the lack of a central government in Somalia, and the Iraq War. The real per capita Gross Domestic Product (GDP) growth during the 1990s was only 1.3 percent per year. The slow economic growth has led to little expansion of employment in the formal sector, resulting in persistent problems of unemployment, particularly among young people. But, the strong economic performance in Lebanon, Tunisia and, recently, the Sudan suggests that these problems are not insurmountable.

For most of the 13 NENA countries, agricultural exports represent a relatively small share of total exports. Wheat is a staple food and a major import commodity for most of the 13 NENA countries. Almost all of them are net food importers. Some countries in the region have relatively high levels of protection for farmers. Egypt, Morocco and Tunisia are among the 15 most protected economies in the world, according to one study. The commodities that are the most protected in the region are wheat, sugar, dairy, and livestock products. The European Union (EU) is the most important trading partner for most of the countries in the region.

Trade agreements
The NENA countries have signed a series of multilateral, regional and bilateral trade agreements. The Uruguay Round Agreement on Agriculture has had only a modest impact on trade policy in the
region. Seven of the 13 NENA countries are either not members of the World Trade Organization (WTO) or they are least developed countries. Somalia, Syria, and the West Bank and Gaza are not WTO members while Djibouti, Somalia, the Sudan and Yemen are least developed countries. The seven countries are, therefore, exempted from most of the agreement’s commitments. For the remaining six countries, the bound rates are often far above the applied tariff rates, particularly for agricultural products. So, the agreement commitments to reduce the bound rate have had little effect on the actual level of agricultural protection.

The EU has signed European Union-Mediterranean Association Agreements (EMAA) with five NENA countries, and three others are in the process of ratification. But, the EMAAs make only general exemptions for agriculture. In 2001, the EU launched the “Everything But Arms Initiative”, under which the least developed countries have duty-free access to EU markets for almost all goods. Within the NENA region, only Djibouti, Somalia, the Sudan and Yemen can take advantage of the initiative’s provisions. Bananas, rice and sugar were temporarily exempted, and duty-free access was delayed until January 2006, July 2009, and September 2009, respectively.

Under the “US-Middle East Free Trade Initiative,” the United States has signed bilateral free trade agreements (FTAs) with Jordan and Morocco and intermediate agreements with four other NENA countries. The effect of the US-Jordan FTA will be small because Jordan’s level of protection is already low and because US-Jordan trade is small. The effect of the US-Morocco FTA will be larger because Moroccan trade barriers are higher. Of particular importance, Morocco’s wheat tariffs will be phased out over ten years. The “US-African Growth and Opportunity Act” allows duty-free access to US markets for sub-Saharan African countries that meet certain criteria; but, within the 13 NENA countries, only Djibouti qualifies.

A number of bilateral and regional agreements within the NENA region have been signed. But, the effectiveness of these agreements has been limited thanks to the structural similarities of the NENA economies and the exclusion of sensitive products.

In spite of these factors, a number of NENA countries, most notably Egypt and Tunisia, have reduced tariff barriers unilaterally in recent years. In other words, trade liberalization has occurred outside the context of global, regional and bilateral trade agreements.

**Impact of trade liberalization**

The reduction of agricultural subsidies by member countries of the Organisation for Economic Co-operation and Development (OECD), combined with the reduction of protection in the context of global trade liberalization, will help increase world agricultural prices. The markets for wheat, rice, sugar, cotton and dairy products are currently the most distorted, and the prices in these markets will rise by 3-20 percent. Since almost all 13 NENA countries are net importers of agricultural products, they are likely to lose because of global liberalization. The report estimates the terms-of-trade effect of a 15 percent increase in world agricultural prices on the 13 NENA countries at approximately US$1.2 billion, or 0.2 percent of regional GDP. This estimate is an upper limit because it assumes no response from producers and consumers and excludes efficiency gains resulting from reduced distortions in domestic agricultural markets. Most studies of trade liberalization suggest that the efficiency benefits are larger than the terms-of-trade losses.

Several dozen studies examined the macroeconomic impact of various types of trade liberalization in NENA. These studies suggest that multilateral trade liberalization generally results in net gains to countries in the region, with real GDP expanding 1-3 percent. The benefits of trade liberalization to a given country depend largely on the degree of domestic liberalization carried out by the country. Most of the gains from agricultural trade liberalization are associated with domestic reform rather than changes in trade policies in other countries. In addition, the benefits of multilateral trade liberalization are generally greater than the gains from bilateral trade agreements with the EU, the US or the region’s own trade agreements.
Effects on small farmers and the poor

Few studies look at the distributional effect of liberalization on small farmers and the poor in the NENA countries. The report uses household survey data and computable general equilibrium (CGE) models to simulate the impact of trade liberalization on small farmers and the poor in four NENA countries.

The case of Egypt

Egypt has undertaken significant trade liberalization, but costly obstacles to doing business and investing remain. It is a major wheat importer and exports cotton, rice and horticulture. The report analyses data from the 1998 Egypt Integrated Household Survey to find out the distributional effect of hypothetical changes in agricultural prices.

According to this analysis, a 40 percent increase in wheat prices would reduce the incidence of poverty among wheat growers by 3 percentage points. In the case of rice and cotton, a 40 percent price increase would decrease poverty among growers of those crops by 7 percentage points. For fruits and vegetables, an equivalent price increase would lower poverty among horticultural growers by 7 percentage points. The largest effect concerns sugar cane growers. A 40 percent increase in sugar prices would reduce poverty by 20 percentage points, largely because sugar cane growers are poorer and highly dependent on sugar cane income. But, the effect of each of these price increases on national poverty is negligible because only a small share of the population grows each of these crops.

The case of Tunisia

Unlike Egypt, Tunisia maintains high tariffs on many products, including agricultural commodities. At the same time, Tunisia has a relatively good investment climate, which contributed to significant inflows of foreign direct investment and a healthy growth rate through the 1990s. Tunisia’s main exports are olives and dates, while the principle imports are wheat and maize. In order to study the distributional effect of trade liberalization in Tunisia, the report uses a CGE model linked to survey data for 400 representative households. The results show that domestic trade liberalization has the largest positive effect on GDP. But, elimination of all tariffs under global trade liberalization has the most positive effect on agriculture and poverty.

The case of Syria

Syria has one of the most highly regulated economies in the region. Reforms in recent years have only begun to dismantle some of these restrictions. Although Syria has been successful in achieving wheat self-sufficiency and promoting cotton exports, these accomplishments have come at a high cost. Inefficiency and an unsustainable fiscal burden marked the process. In addition, the likely depletion of oil reserves is forcing the Government to reduce costs and find new sources of revenue.

The report uses a CGE model to simulate the effect of liberalizing wheat markets on households in ten income categories. The macroeconomic effects are relatively modest, although government savings increase by almost 3 percent of GDP. Complete liberalization reduces the producer price of wheat by about 17 percent and production by about 2 percent. The removal of subsidies results in gains for high-income households and losses for lower-income households. The size of the effects, however, is less than 1 percent of base income for all but the richest income category.

The case of Morocco

Since the mid-1980s, Morocco has carried out a series of economic reforms to allow the market to play a larger role in production and consumption decisions. This includes price liberalization, a reduced role for state enterprises and the promotion of private investment. Morocco has also signed an EMAA with the EU and an FTA with the United States. But, the level of agricultural protection remains relatively high.
A study by Ravallion and Lokshin (2004) uses a CGE model to simulate the effect of grain import liberalization and then uses projected price changes to simulate the impact on households in a nationally representative survey. The CGE model suggests that full liberalization of grain imports would reduce the producer price of grain by 24 percent and the consumer price of grain by 27 percent. This reduces poverty in urban areas, where households benefit from lower priced grain, but raises poverty in rural areas because of losses for net sellers of grain. The overall incidence of poverty in this case rises from 20 percent to 22 percent.

Implications for trade policy

Global trade liberalization

Global trade liberalization will likely increase world agricultural prices by 3-20 percent, imposing a terms-of-trade loss on 11 of the 13 countries under consideration. The Sudan and Turkey will have small agricultural trade surpluses. The net food-importing countries have used the expected terms-of-trade loss associated with global trade liberalization to request special concessions in the form of reduced commitments to opening their own borders.

The effect of agricultural trade liberalization on poverty varies widely across countries in part because the effect of liberalization on agricultural prices is ambiguous. Global agricultural trade reform is likely to increase world agricultural prices, but domestic trade liberalization will reduce domestic agricultural prices relative to the world price. The net effect of liberalization on domestic agricultural prices depends partly on the country's trade patterns, the original level of protection and the details of the liberalization. If the level of domestic protection is high, then full trade liberalization is likely to reduce domestic agricultural prices. If, on the other hand, domestic protection is modest, then full trade liberalization may increase domestic agricultural prices.

The impact of changes in agricultural prices on poverty is ambiguous. The analysis presented in this report suggests that higher agricultural prices benefit poor farmers who can produce a marketed surplus, but the effect is quite small and the impact on poverty levels is weak. This suggests that trade policy is a poor instrument for addressing overall poverty in the region.

Regional integration

The economic benefits of regional integration, through, for example, the Greater Arab Free Trade Agreement, have been limited to date. One reason for this is that these agreements tend to be fairly flexible, allowing numerous exceptions for "sensitive goods". A relatively small number of exceptions can largely negate the gains from trade liberalization. To generate significant gains for member countries, the Greater Arab Free Trade Agreement and other regional agreements will have to achieve a greater level of discipline over tariff and non-tariff barriers. The second reason for the modest benefits associated with these trade agreements is that regional trade is hampered by trade policies and various other factors. For example, the transportation infrastructure linking NENA countries is generally poor. Transportation services in the region are characterized by the lack of competition and high costs. Many NENA countries suffer from cumbersome customs procedures that raise the cost of trade. Measures to streamline customs procedures and introduce greater competition in regional transportation services would enhance the benefits of regional trade agreements. Another reason for the modest gains associated with regional trade agreements is the similarity of the economic structures in the member countries. If all member countries import wheat and maize, export fruits and vegetables and have similar wage rates, then the gains from trade are likely to be limited.
Bilateral agreements
In the area of bilateral agreements, the EMAAs generally exclude agriculture. Simulation studies confirm the economic intuition that the gains from these agreements would be much larger if they included liberalization in the agricultural sector. The five NENA countries with EMAAs should begin to explore the feasibility of a second round of negotiations that would include agriculture. While recognizing the political sensitivity of agricultural prices, NENA countries should keep in mind that most of the benefits of an expanded association agreement depend on the degree of domestic liberalization in their own countries. At the same time, the liberalization of EU tariff and non-tariff barriers on fruits, vegetables, olive oil and sugar would be particularly beneficial to NENA countries.

The impact of US FTAs is rather limited because the United States is a relatively minor trading partner with all of these countries. But, these agreements can facilitate local and foreign investments in the 13 NENA countries. FTAs include measures to create a more favourable climate for private investment and signal a commitment to greater integration in the global economy.

Unilateral liberalization
Unilaterally reducing import protection and domestic support for agriculture will increase aggregate income. Indeed, it is easy to demonstrate that the benefits of lower domestic prices to consumers are greater than the losses to producers. Yet, policymakers, trade negotiators and many non-economists see reducing domestic protection as the “price” a country must pay to gain access to markets in other countries. Some argue that poor farmers in developing countries, particularly in the NENA region, cannot compete with large-scale, technologically advanced and subsidised farmers in developed countries. But, in spite of the agricultural subsidies of developed countries, Egypt is a competitive exporter of cotton and rice, Morocco is able to export tomatoes to Europe, and Tunisia is a major exporter of olive oil. These examples suggest that NENA countries can compete in markets where they have comparative advantage.

According to another argument, import barriers on agricultural products reduce poverty among poor agricultural producers. The analysis presented in this report suggests that higher agricultural prices have small and mixed effects on the poor, because:

- higher agricultural prices benefit some poor households (farmers with net sales), but they hurt other poor households (the urban poor and net buyers in rural areas);
- the percentage of households that are net sellers of agricultural goods is relatively small;
- farmers who are net sellers tend to be richer than the average farmer, so higher farm income does not always translate into lower poverty; and
- even those farmers who are both poor and net sellers rely on non-agricultural activities for a significant share of their incomes.

These factors indicate that agricultural protection is a costly and ineffective tool with which to address the problem of rural poverty.

Complementary policies
Flexible factor markets
The impact of trade liberalization on small farmers and other poor households in the NENA region partly depends on non-trade policies. Several studies suggest that the size of gains from trade liberalization will be greater when there are flexible factor markets. Such markets should allow the transfer of land, labour and capital from formerly protected sectors to newly profitable sectors.
Regulations that hinder the response of these flexible factor markets reduce the positive impact of liberalization. In agriculture, effective agricultural services, such as extension and market information systems, are likely to enhance flexibility. Such systems should provide farmers with useful information about the agronomic and economic aspects of shifting into new commodities.

Trade Facilitation
Another type of policy that enhances the economic effect of trade liberalization is trade facilitation. This refers to measures that reduce the transaction costs related to trade, including:

- excessive documentation requirements;
- authorizations from multiple agencies;
- unclear or subjective criteria for applications of duties; and
- delays and uncertainties related to customs clearance.

One study found that the gains from trade liberalization are twice as large if combined with trade facilitation measures.

Green box programmes
Under World Trade Organization rules, the agricultural sector can receive direct support through a variety of green box programmes. Such programmes involve mainly the provision of public goods and may include, for example, agricultural research and extension, pest and disease control, inspection services, marketing infrastructure, market information services, environmental protection and regional assistance.

Decoupled payments
One type of green box programme does not involve the provision of public goods. This type is based on decoupled payments to farmers system. Payments are decoupled when they are not based on current production, but rather on some fixed-basis production or on area planted in a base year. Over the last 15 years, economists and policymakers have become increasingly interested in agricultural reform that shifts from producer subsidies and import protection towards decoupled payments to farmers. The EU, Mexico, Turkey and the United States have tried this type of reform with some success. However, switching from import protection to a programme of decoupled payments implies both a loss in tariff revenue and a significant new expenditure.

Safety-net programmes
If the objective is to assist poor and vulnerable households regardless of their occupation, a different type of programme should be considered. A wide variety of safety-net programmes has been established in developing countries with the goal of reducing poverty. Targeted food subsidies make subsidized food available to selected households based on geographical location, through low-price shops located in poor neighbourhoods, or some form of ration card that entitles the bearer to purchase food at subsidized prices. Egypt, Jordan and Tunisia have attempted to introduce targeting into food subsidy programmes.

Labour-intensive public works programmes usually combine infrastructure development, such as road building, with hiring policies to maximize the pro-poor impact. If well designed, they can improve community infrastructure and assist the poorest households with able-bodied members.

Conditional cash transfer programmes have generated considerable interest in the last 10-15 years. These programmes provide cash grants to households that comply with certain requirements, usually keeping children in school, attending health clinics, or receiving pre- and postnatal care. Conditional cash transfers provide direct assistance to poor households. They also encourage investments in human capital that reduce the chance of transmitting poverty to the next generation.