



**INSTITUTO DE ESTUDOS DO COMÉRCIO E NEGOCIAÇÕES INTERNACIONAIS
INSTITUTE FOR INTERNATIONAL TRADE NEGOTIATIONS**

Working Group on EU-Mercosur Negotiations

***Fast-Tracking a "feasible" EU-Mercosur Agreement:
Scenarios for Untying the Agriculture Knot¹***

MARCOS SAWAYA JANK (Coordinator)

President of the Institute for International Trade Negotiations - ICONE

JEAN-YVES CARFANTAN (Coordinator)

Professor of the French Consortium of Agriculture University Colleges

GÉRALDINE KUTAS

Ph.D. Candidate at the *Institut d'Études Politiques de Paris, SciencesPo*

ANTONIO JOSINO MEIRELLES NETO

Researcher, ICONE

ANDRÉ MELONI NASSAR

Researcher, ICONE

JOAQUIM HENRIQUE DA CUNHA FILHO

Researcher, ICONE

**São Paulo
April, 19th 2004.**

¹. Draft prepared for the "Working Group on EU-Mercosur Negotiations" of the Mercosur Chair of Sciences Po, Paris, and presented on March 29, 2004 in a workshop held at the Faculty of Law of the University of Barcelona, Spain. Comments are welcome and can be sent to the co-authors at msjank@iconebrasil.org.br and carfy@ig.com.br.



**Instituto de Estudos do Comércio e Negociações Internacionais
Institute for International Trade Negotiations**

Mission

ICONE is an independent non-profit organization that aims to develop studies and applied research in order to support international trade negotiations and contribute to a broader integration of Brazil into the world economy.

Team

President	Marcos Jank
Executive Director	André Nassar
Public Affairs Director	Maria Helena Tachinardi
Senior Researchers	Mário Jales & Zuleika Arashiro
Junior Researchers	Antonio Meirelles, Joaquim Cunha Filho & Leandro Araújo
Administrative Coordinator	Telma Pereira
Interns	Alejandro Chacoff, Cynthia Marin & Gustavo Sugahara

Contact Information

Avenida General Furtado do Nascimento, 740, cj. 81
São Paulo, SP 05465-070 Brazil

Telephone / Fax: 55-11-3021-0403

www.iconebrasil.org.br

icone@iconebrasil.org.br

Material in this publication may be reproduced, provided the source is properly acknowledged.

TABLE OF CONTENTS

Executive Summary.....	4
Introduction	7
I. Evolution of the EU Trade Policy	10
1.1 The CAP Reforms.....	10
1.2 Preferential Agreements Frameworks	16
1.3 Impact on Trade of EU Enlargement.	17
II. Agricultural Sensitive Products in the EU-Mercosur Negotiations..	19
2.1 Bovine Meat.....	23
2.2 Chicken Meat	27
2.3 Pork meat	30
2.4 Sugar & Ethyl Alcohol.....	32
2.5 Fruits.....	35
2.6 Orange Juice.....	36
2.7 Dairy products	37
2.8 Cereals	39
2.9 EU Offensive Interests in the Agricultural Sector	42
III. Scenarios and Conclusions	45
1. Optimistic Scenario	45
2. Pessimistic Scenario	46
3. Feasible Scenario	46
<i>Abbreviations and Acronyms</i>	49
<i>Bibliography</i>	51

Executive Summary

1. The International Context of the Negotiations on Agriculture

The failure of the WTO ministerial conference in Cancun in September 2003 and the recent difficulties in progressing discussions on the Free Trade Area of the Americas (FTAA) has enhanced the importance of the EU-Mercosur negotiations for the establishment of a bi-regional Free Trade Area (FTA).

Given the fact that Mercosur's agricultural products exports represent 29 billion dollars of its total exports and that the EU imports 35% of it, market access for agricultural products became a core issue in the current negotiations. However, the reforms on trade policy instruments practiced by EU's Common Agricultural Policy (CAP) are taking place very slowly, which shows that current export and domestic subsidies will not be fully eliminated in the scope of EU-Mercosur FTA. Therefore, discussions are supposed to be focused in the reduction of tariff rates and accession through tariff rate quotas (TRQs).

The accession of 10 new members that will join the EU in May 2004 may also influence the outcome of the EU-Mercosur negotiation. As a result of accession to the single market of the EU, there are likely to be significant implications for trade regimes and trade flows for the majority of the new members. Recent trade developments between the EU-15 and the new Member States show the increasing growing share of the EU in the trade flows with those markets, which already limits or reduces the third countries market shares in Europe. Upon accession to the EU - in 2004 or later -, the applicant countries will apply the EU trade regime towards third countries, starting with conversion of their current import tariff rates to those of the EU. Under WTO rules, a country has a right to claim compensation for the loss or reduction of market access if it loses preferential access or faces higher tariff rates as a consequence of its trading partner joining a customs union. This point will certainly influence the building of an agreement between the EU and Mercosur on agricultural trade liberalization. Mercosur Members will certainly apply for compensation for loss or less accessible markets.

2. Sensitive issues in the Agriculture discussions

Agriculture market access negotiation brings a list of sensitive products that may deadlock the overall discussions due to their importance in the EU-Mercosur inter-regional trade flows and the current market access restrictions that they face in exporting markets.

These products include, basically: bovine, chicken and swine meats, sugar and ethanol, cereals, dairies, tobacco and fruits, all of them being important products for Mercosur exports. For the selected products, high tariffs

and limited TRQs can be identified showing that a feasible agreement for Mercosur should take place through substantial tariff reduction and the concession of exclusive TRQs.

However, some products of great importance to the EU such as wines and other spirits may also complicate discussions, since they touch the harmonization of geographical indications (GIs) rules. With an important production of traditional beverages, the EU pushes to the establishment of a stricter agreement on GIs.

After taking into account a sector by sector analysis concerning the main sensitive agricultural products identified, it is possible to trace more flexible results and different scenarios for each product, which may reflect a more realist outcome for the negotiations on agriculture.

3. Scenarios for the EU-Mercosur negotiations

In order to trace scenarios for the negotiations on agriculture, the following paper has taken into account the complexity of each block interests and the genuine constraints that they face. To complete this exercise, the two most radical positions regarding the development of the negotiations on agriculture, which are those of France and Brazil, have been collected. Since there is almost no point of consensus between the stances expressed by these two countries, "feasible" scenarios stand necessarily in between of the two positions and should be built on a product-by-product approach.

Optimistic scenario

This scenario would represent positive prospects for inter-regional trade as well as considerable changes in the EU domestic market. Both parties should agree with a substantial and horizontal liberalization among the most important agricultural products of the EU and Mercosur, thus enhancing inter-regional trade flows through preferential access for products exported by both regions. This process could take place gradually but should include the following changes:

- a) Substantial reduction of over-quota tariffs allowing products, such as cereals, meats, sugar and dairy to enter in the EU market.
- b) If over-quota tariffs were not substantially reduced, a considerable amount of tariff rate quotas should be allocated to Mercosur countries exclusively with preferential access.
- c) Special Safeguard measures (SSG) should be suspended.
- d) Revision of quotas administration method should take place.
- e) Successful agreement on geographical indications for wines and spirits.

Pessimistic scenario

A pessimistic scenario would maintain the *status quo* of the EU domestic market protection in the most sensitive products. This scenario would, however, establish a preferential access intra-quota, and would include:

- a) Expansion of preferential access for some strategic products (i.e. meats and dairy). However, access conceded through quotas would be limited compared to Mercosur export potential for agricultural products.
- b) No reductions on over-quota high tariff rates.
- c) No suspension of special safeguard measures.
- d) No reform of quotas administration methods.

Feasible and most probable scenario

A feasible scenario – and the most likely – would be more complex, involving a combination of the different needs for each sensitive sector. Some problems – such as TRQs and TRQs administration – which are horizontal to most sensitive sectors – would receive special attention in the negotiations, thus implying reforms and new access in this area. New access, for some products, could take place through a two-step approach. According to this modality Mercosur goods will be granted some preferential and limited access to the EU market through the EU-Mercosur FTA. Then, Mercosur will receive an [X] percentage of the global volume that the EU will offer to third countries at the WTO. On the other hand, some particular sectorial demands would also shape the results of EU-Mercosur FTA.

The results of negotiations will, however, depend on the level of ambition of the trade-off with other areas under negotiation (non-agricultural market access, services, government procurement, etc.). If the trade-off offered is ambitious, expressive quotas and tariff preferences may be offered to Mercosur exports. On the contrary, in the case that trade-off offers are not significant, only small preferences on quotas and tariffs could be conceded. However, as regards trade-offs, it is important to underline that the acceptance of Mercosur to remove export subsidies and domestic support from the list of issues to be negotiated bilaterally is per-se a significant concession that should be taken into consideration in the global trade-off. In addition, to compensate the absence of measures to eliminate export subsidies, the EU would have to accept the creation of intra-bloc safeguards that would be able to neutralize the impact of export subsidies granted by the EU to products exported to Mercosur, especially in the case of dairies exports. In addition, through the two step approach, a better access to Mercosur exports into the EU will depend on the level of ambition of third countries which are also market access demanders. The two step approach may, therefore, be interpreted as a strategy to reduce Mercosur's ambition concerning market access in the Doha Round which seems to be not acceptable from the point of view Mercosur's interests.

19 April 2004

Working Group on EU-Mercosur Negotiations

Fast-Tracking a "feasible" EU-Mercosur Agreement: Scenarios for Untying the Agriculture Knot²

*Marcos Sawaya Jank (Coordinator)³
Jean-Yves Carfantan (Coordinator)⁴
Géraldine Kutas⁵
Antonio Josino Meirelles Neto⁵
André Meloni Nassar⁵
Joaquim Henrique da Cunha Filho⁶*

Introduction

Negotiations between Mercosur and the European Union (EU) began in April 2000, in the EU-Mercosur Bi-regional Negotiations Committee (BNC). Created by the end of 1999, this committee has been entrusted with conducting bi-regional talks aimed at the conclusion of an Interregional Association Agreement. Negotiations should conclude by the end of 2004.

Market access for agricultural goods is one of the main issues of the current EU-Mercosur Free Trade Agreement (FTA) negotiations. Both the EU and Mercosur already defined modalities and methods for the completion of negotiations, aiming at the substantial liberalization of bi-regional trade flows and the consequent increase of trade flows between these two regions.

On the one hand, the EU is a net importer of agricultural products from Mercosur, which has clear comparative advantages in exporting high quality and low priced agricultural products to the Community's market. Table 1 shows that agricultural exports to the EU account for 35% of all Mercosur agricultural exports to the world. Agricultural products represent around 48% of Mercosur total exports to the EU. On the other hand, EU exports of agricultural products to Mercosur are not significant. In 2002, around 700 millions euros were exported from the EU to Mercosur, which represent only 3% of total EU exports to this bloc. Main exports consist in wines, spirits, malt and olive oil.

². Draft prepared for the "Working Group on EU-Mercosur Negotiations" of the **Mercosur Chair of Sciences Po, Paris**, and presented on March 29, 2004 in a workshop held at the Faculty of Law of the University of Barcelona, Spain. Comments are welcome and can be sent to the co-authors at msjank@iconebrasil.org.br and carfy@ig.com.br.

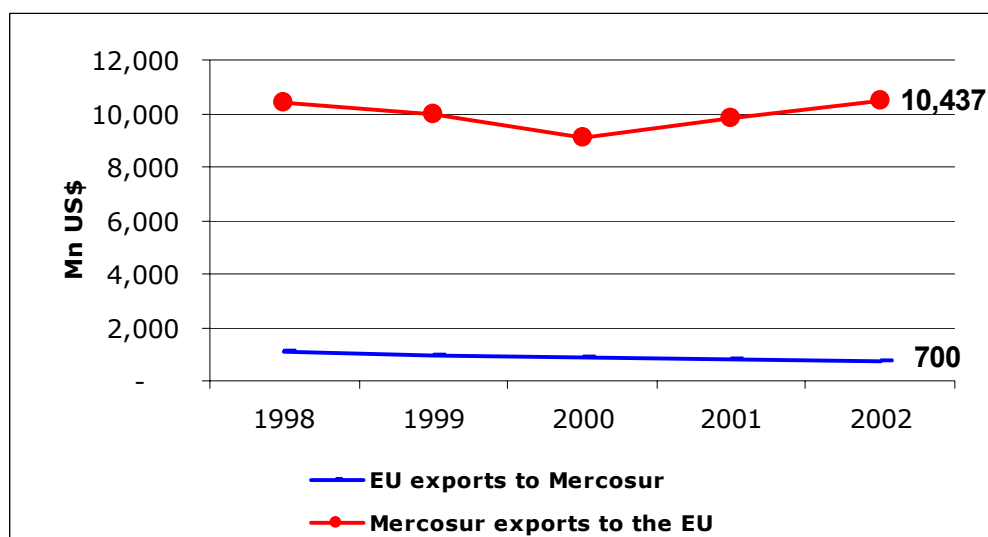
³. Associate Professor at the University of São Paulo and President of the Institute for International Trade Negotiations (ICONE).

⁴. Professor of the French Consortium of Agriculture University Colleges.

⁵. M.Sc. in Latin American Studies, Georgetown University, Washington, DC, and PhD Candidate at the *Institut d'Études Politiques de Paris*.

⁶. Researcher at the Institute for International Trade Negotiations (ICONE).

Figure 1
Evolution of EU-Mercosur agricultural trade flows



Source: DataIntal, IDB.

Mercosur's strong interest in market access for agricultural products pushes, therefore, the EU to negotiate an ambitious package of market access for agricultural goods. As a result, bi-regional negotiations have been complicated in this area.

Table 1
Exports of Mercosur agricultural products – 2002

Mn. US\$	Total exports	Agricultural exports to the EU	%
Argentina	11,245	3,422	30.4 %
Brazil	16,910	6,773	40.1 %
Paraguay	770	35	4.5 %
Uruguay	853	208	24.4 %
Mercosur	29,778	10,437	35.0 %

Sources: DataIntal/Brazilian Ministry of Industry, Development and Foreign Trade

In fact, the most competitive agricultural export products originating from Mercosur face substantial barriers to enter the EU market whilst a large number of preferences is offered to several third countries, which are, sometimes, less competitive. These restrictions are usually a consequence of EU domestic policies, such as domestic support to producers. However, high tariffs, restrictive tariff rate quotas (TRQs), minimum entry price, special safeguards and sanitary measures are also applied on Mercosur's competitive agricultural exports.

Despite Mercosur's interest to discuss export subsidies and domestic support in the bi-regional negotiation, the EU wants to push these issues to the multilateral negotiations, at the World Trade Organization (WTO), and stresses that provisions concerning national treatment should not prevent the practice of subsidizing domestic producers, exclusively. According to Mercosur's position, export subsidies should not be applied on bi-regional exports and should be eliminated as soon as the FTA enters into force. Besides, Mercosur wants to discuss mechanisms, such as safeguards, to compensate trade distorting effects caused by the EU domestic subsidies.

In this regard, the failure of the WTO ministerial conference in Cancun in September 2003 postponed any effort to tackle such issues in bilateral negotiations between the two blocs. In addition, the fact that the Free Trade Area of the Americas (FTAA) negotiation is proceeding somewhat timidly weakens the incentives to negotiate an ambitious preferential trade agreement between Mercosur and the EU.

In addition, a new issue may influence the outcome of the current EU-Mercosur agricultural negotiation. Ten countries (including eight Central and Eastern Europe Countries) will join the EU in May 2004 and possibly two more a few years later. As a result of accession to the single market of the EU, there are likely to be significant implications for trade regimes and trade flows for the majority of the new members. Recent trade developments between the EU-15 and the new Member States show the increasing growing share of the EU in the trade flows with those markets, which already limits or reduces the third countries market shares in Europe. Upon accession to the EU - in 2004 or later -, the applicant countries will apply the EU trade regime towards third countries, starting with conversion of their current import tariff rates to those of the EU. Under WTO rules, a country has a right to claim compensation for the loss or reduction of market access if it loses preferential access or faces higher tariff rates as a consequence of its trading partner joining a customs union. This point will certainly influence the building of an agreement between the EU and Mercosur on agricultural trade liberalization. Mercosur Members will certainly apply for compensation for loss or less accessible markets.

The objective of this paper is to elaborate feasible scenarios for the EU-Mercosur negotiations in agriculture, taking into account the complexity of each party's interests and the genuine constraints they face. To complete this exercise, the two most radical positions regarding agricultural negotiations development and conclusions, which are those of France and Brazil, have been collected. Since there is almost no point of consensus between the stances expressed by these two countries, "feasible" scenarios stand necessarily in between of the two positions and should be built on a product-by-product approach. The text is essentially analytical and intends to show how import regimes work for the most sensitive sectors that are at stake in the current negotiations in order to identify possible changes that could be part of a bi-regional FTA. Therefore, this study shows the evolution of protection instruments for these products through an historical perspective of the

Common Agricultural Policy (CAP) reforms, the current status of these regimes and certain aspects that may influence the decision making process, such as the enlargement of the EU. The first section of this paper will review the evolution of the EU trade policy, focusing on the reforms of the CAP and on the preferential trade agreements concluded by the EU. The second section is dedicated to a product-by-product analysis of the main sensitive products that impede the negotiations. This study is centered on customs duties (tariffs and TRQs) applied to imports originating from both regions. Tariffs reduction and/or elimination, TRQs expansion (although a second-best) and TRQs administration are discussed for these products. Finally, three feasible scenarios are proposed for untying the agricultural knot of the EU-Mercosur negotiations.

I. Evolution of the EU Trade Policy

The experience of the last ten years indicates that the EU is still pursuing its attempt to combine trade preferences and WTO market access commitments with the protection of domestic production, manipulating the concessions in order to avoid radical changes in consolidated trade flows. As a huge market, the EU has enormous bargaining power in a bilateral negotiation like the one with Mercosur countries. As a result the EU preferential agreements have generally not challenged the existence of strong protection for EU agriculture. No one can imagine that a bilateral negotiation involving Latin American countries and the EU will provide conditions for the EU to eliminate or radically reduce its border protections in all products. Such a result could only be obtained as a consequence of a well-succeeded WTO round of multilateral negotiations. Actually in the building of an agreement with Mercosur, the EU is pursuing freer non-agricultural trade and services and is trying to avoid the liberalization of its highly protected agricultural market.

The choice of a very pragmatic and limited liberalization framework is based on two main considerations: the very limited market access provided by the CAP reforms already implemented and the outline of the different regional and preferential trade agreements signed by the EU over the last ten years.

1.1 The CAP Reforms

Although going in the right direction the CAP reforms already implemented or decided are too limited and too gradual to provide a framework for a radical liberalization of the EU-Mercosur agricultural trade. The EU border protection is still very high for some commodities such as sugar, dairy products, meats or fruits. It has not been dismantled and will be extended to new members. The experience shows that changes in border protection only come about as a result of a very strong exogenous pressure rather than endogenous factors. The Uruguay Round Agricultural Agreement (URAA) has been a first step towards a reduction in trade barriers and elimination of discriminatory treatment of trade in agricultural products. However, tariffs remain high in the EU like in many countries. The average level of tariffs is only one aspect of the

problem. Many tariff peaks remain and tariff dispersion is still very pronounced.

Table 2
Average *ad-valorem* equivalent tariffs for agricultural products in the EU and Mercosur

Tariff Profile	Mercosur	EU
Mean	9.9 %	29.3 %
Median	10.0 %	14.4 %
Standard deviation	5.0 %	40.3 %
Maximum	20.0 %	277.2 %
Minimum	0.0 %	0.0 %
Coefficient of variation	0.51	1.37

Notes:

1. *Ad-valorem* tariffs are calculated as a percentage of the value of goods, which is normally the cost, insurance and freight (CIF).

2. The arithmetic mean is what is commonly called the average and is the sum of all the scores divided by the number of scores. Dispersion is measured through standard deviation, which measures the degree to which a value varies from the distribution means. The median is the midpoint of a tariff schedule's distribution in ascending order of value: half the scores are above the median and half are below the median.

Sources: European Commission and Brazilian Ministry of Industry, Development and Trade.

From the Mac Sharry Reform to the Agenda 2000

In response to the General Agreement on Tariffs and Trade (GATT) negotiations leading to the URAA, the EU implemented a comprehensive reform of the CAP in 1993. The so-called Mac Sharry reform involved two major components: the reduction of price guarantees for a number of products and the introduction of direct payments to producers as compensation for the lower prices. The products involved were cereals, oilseeds and protein crops for which producers receive acreage support. A similar system based on direct payment per head of animal (head age premiums) applies to the production of feeding cattle, sheep, lambs, and goats. The implementation of support for compulsory land set-aside was also part of the reform. The introduction of acreage and head age support was a compromise between the United States (US) and the EU in the Uruguay Round negotiations where the two parties agreed on reducing price support and on compensating farmers by direct support.

In 1999, thinking about the enlargement process and to the continuation of the trade negotiations at the WTO, EU Heads of State reached an agreement on a second reform, the so-called Agenda 2000 reform package. A second worry, in a time of financial stringency, was linked to the cost of agricultural support.

Covering the period 2000-2006, the reform package was built on the principles of the policies established in the Mac Sharry reform, involving reductions of guaranteed prices for a number of agricultural products, and the

introduction of income compensation to farmers in the form of direct support. It gave an indication as to how far the EU was willing to go in reducing trade barriers. For cereals, the intervention price was reduced by 15%, and compensatory payments were increased by 17% over the period 2000-2002. To be eligible for acreage payment, farmers were committed to set-aside productive farming land (compensated by acreage payments). For dairy products the intervention prices of butter and skimmed milk powder were reduced by a similar amount, and producers were compensated by direct payments. For beef and veal, prices were to be reduced by 20% in three steps from 2000 to 2002, reducing the price of intervention effectively by 25%, and producers were compensated by direct support. This was a way to extend various support schemes.

The Agenda 2000 reform package was very far from a radical revolution. It did not include any of the substantial liberalization assumed in most studies that have modeled the international effects of a CAP reform. These more radical reforms are unlikely to happen before 2010. Instead, Agenda 2000 limited the CAP reform to measures designed to deal with more immediate worries about the WTO, the budget, and the forthcoming enlargement of the EU. The 1999 reform was primarily concerned with a small number of products only, of which cereals and beef are likely to be more important for third countries. Other sectors of interest, notably sugar, were not causing the same level of concern in terms of meeting the GATT EU commitments and some of them had been dealt with already in separate negotiations. The broad objective of this second reform was to reduce the level of intervention prices – that is, the prices at which the EU steps in as a buyer of last resort in order to maintain prices – and to partially offset this diminution through an increase in direct income support to farmers. One of the main goals was to enable producers to export at world market prices, thus avoiding any Uruguay Round restrictions on subsidized exports⁷.

The overall level of support for agriculture has been little affected by the reform, the main effects being the conversion of price support to direct support linked to land use or to the number of animals. The compensatory payments were placed in the WTO “blue box”, which is exempted from reduction. However because it is linked directly or indirectly to production, the maintenance of such support can be considered as a serious loophole regarding market access improvement and an obstacle to a more level ground for competition on the world markets. As regards market access, the only positive aspects of the Agenda 2000 reform package is the fact that it brought border protection in the EU close to the *de minimis* level for wheat, and also reduced border protection for beef and veal, and for dairy products, although from a very high level. A number of products were not affected by the Agenda 2000

⁷. Another point was to contain the budgetary cost of the CAP. The ultimate objective was to prepare the enlargement. The prospect to include central and eastern European states, many with large agricultural sectors, made the resolution of both WTO and budget problems more urgent. If an unreformed CAP were applied to the new entrants, both the budgetary cost and the volume of surplus production eligible for storage or subsidised export would spiral.

reform, including pork and poultry meat, fruits and vegetables, and sugar, the latter being subject to very high protection in the EU⁸.

There were questions of strategy as well as principle involved in the Agenda 2000 package. The EU saw advantage in deferring liberalization until the next Round of WTO negotiations. Since negotiations take the form of trading different concessions, any unilateral liberalization implemented at the beginning of the 2000-decade could have been seen as reducing the EU's stock of bargaining counters with which to buy improved access to other markets during the next WTO Round.

The 2003 Fischler Reform

Because the Agenda 2000 reform was disappointing and limited and given the fact that it did not address seriously the enlargement issues, the 'mid-term reviews' scheduled for 2003 became the new reform objective of the European Commission. In 2002, the European Commission stated that it remained committed to the support of the EU agriculture sector. However, it was also challenged in meeting this objective by four concerns:

- The requirement to incorporate 10 new Member States into the EU within the constraint of a limited agriculture budget.
- The necessity to meet growing consumer expectations with regard to environmental, food quality and animal welfare standards and the desire to make production more market and consumer focused and less dependent on intervention⁹.
- The goal of increasing the proportion of budgetary spending on rural development initiatives as opposed to commodity price supports.
- The obligation to tailor the EU agriculture policy in a way that will allow the optimal outcome for the EU in future WTO agriculture negotiations.

In the face of EU expansionary pressures, a fixed budget, increasing consumer awareness and external political factors, the Commission argued that existing EU agricultural policies would not deliver the best outcomes for those involved in farming. Taking this into account and following the line of the Agenda 2000, a relevant strategy for the EU would have been to remove price guarantees for products for which the EU is still maintaining high border protection (sugar, dairy products, beef & veal in particular), to compensate

⁸. With the acceptance of the *Everything But Arms* proposal in March 2001, the EU has opened its markets to free imports of all products except arms and munitions from the world's 48 Least Developed Countries (LDCs). For sugar and rice there will be a transition period to 2009, and for bananas the transition period will end on 1 January 2006. As imports of these products may already be subject to preferential trade agreements, the scheme is expected to have only marginal impacts on trade between the parties involved.

⁹. At the beginning of the new century, an interesting new set of developments took place, which provided a new driver for reform. European citizens have become increasingly concerned about food quality and safety issues.

farmers by increasing the compensatory payments ("blue box" measures), to fix the compensatory payments under the auspices of the WTO, and subsequently to reduce the support over a fixed period of time. Such a strategy would have made it easier to comply with the rules of the WTO, to lower the cost of direct support to agriculture, and to improve market access to the benefit of developing and developed countries. However, the final agreement differs from that perspective in a number of ways, as deep adjustments to the initial proposal were made to achieve a political compromise.

The Commission's initial proposals involved a very extensive introduction of decoupling of aid payments from the production of individual products. However, when the debate with Member States began, it soon became apparent that exceptions to decoupling would be required in order to secure the approval of the Commission's proposals. The Commission therefore recognized that partial decoupling or deferment of decoupling would be necessary in order to secure a political agreement on the basic shift towards a system of single decoupled farm aid payments (a modification nominally justified by the need to avoid the abandonment of production in marginal farming areas). According to the Commission's initial proposal the overall aim of the proposed reforms was to "enhance the competitiveness of EU agriculture by setting intervention as a real safety net measure, allowing EU producers to respond to market signals while protecting them from extreme price fluctuations". In reality, given that the single decoupled farm aid payment adopted is to be based on payment entitlements over the 2000-2002 period the new system will effectively freeze, under the new nominally less trade-distorting system, the trade distortions generated under the old system. In addition, the link between the single farm-payment scheme and various environmental, food safety and animal-welfare issues cannot disguise the fact that the scheme will serve to maintain EU agricultural production in the commodities concerned at higher levels than those that would prevail where farmers' production decisions are determined solely by the market.

THE KEY POINTS OF THE 2003 FISCHLER REFORM

- A new single farm payment for EU farmers will replace the plethora of existing direct payment schemes in the arable, beef and sheep sectors breaking the link between farm subsidies and production. This new support system is supposed to make farmers free to produce for the market rather than for the subsidy.
- The deal allows Member States to retain limited coupled elements in order to avoid abandonment of production. This could lead to different policies operating across Europe, which could lead to market distortions.
- The implementation of the package will be delayed until 2005. Moreover, Member States have the option to delay implementation even further, until 2007.
- The single farm payment will be linked to the respect of environmental, food safety, animal and plant health and animal welfare standards, as well as the requirement to keep all farmland in good agricultural and environmental conditions ("cross-compliance").
- Support for rural development will be increased by the introduction of modulation on an EU-wide basis. Modulation will start in 2005 and will transfer support from production subsidies to environmental and rural development objectives.
- New measures to promote the environment, quality and animal welfare and to help farmers to meet EU production standards will be added to the rural development program from 2005.

These considerations raise a very important point, namely the production effects of the reforms agreed. The Commission's initial proposals were designed to avoid any abandonment of agricultural production in the EU, and the Member States' modifications were aimed at further strengthening this policy. However this option is likely to increase the incentive to produce in a number of sectors, leading to a rise in EU agricultural production under a reformed CAP, compared to the current levels of production. Increased production is likely to occur in all sectors except beef and rye, and in many sectors the surplus available for export will increase, but at much lower prices than those previously prevailing. Third countries could therefore face increased volumes of EU agricultural exports at lower prices. In addition, with lower priced inputs, some EU value-added food-product manufacturers will be able to obtain their raw materials at around world market prices and thereby to exploit economies of scale by serving the huge internal EU market. This could lead to reduced imports of raw materials and increased exports of lower priced EU value-added food products to world markets. Such a trend was already apparent following the 1992 process of CAP reform and the Uruguay Round of

tariff reductions, after which EU exports of value-added food products increased at an average rate of 25% per annum.

1.2 Preferential Agreements Frameworks

In the different regional and preferential trade agreements signed by the EU over the last ten years, except for the "Everything but Arms" initiative, provisions carefully accommodate the CAP. The maintenance of high CAP prices has been possible because high MFN tariffs that restrict trade (allowing other CAP mechanisms to effectively facilitate and control desired imports) were maintained for the most sensitive products. The EU's ultimate protection for these sensitive products (meats, sugar, cereals, dairy products, fruits) has been to exclude them from Preferential Trade Agreements, providing no import concession, or granting imports concessions within the limits of TRQs¹⁰. The EU provides no tariff concessions for grains, grain products, or the main meat and dairy products in the General System of Preferences (GSP). The EU has bound some of its preferential access commitments to developing countries as TRQ commitments. The most important cover sugar and beef imports from ACP¹¹ countries, banana imports from Latin American suppliers¹², manioc imports from Thailand and Indonesia and meat imports from Latin American suppliers.

Such principles have been fully respected when the EU and the Candidate Members (Poland, Hungary, the Czech Republic, Slovenia, Estonia, Latvia, Lithuania, Slovakia, Bulgaria, Romania, Malta and Cyprus) signed the Europe Agreements and concluded bilateral trade arrangements with the EU. These arrangements lowered trade barriers over 10 years and have been the legal framework for EU relations with applicant states since the nineties. Although the Europe Agreements provide for imports of some sensitive products from Eastern European countries, most of these concessions are TRQs or other variations of quantitative restrictions. This means that the preferential tariff rates apply to small quantities or for limited periods. For instance, substantially lower tariff rates are available to the Central and Eastern European Countries (CEECs) for their exports of beef carcasses and boneless beef (duty free imports in the case of Poland, Hungary and Romania). It should be noted that all those considerable concessions are limited to small TRQs (59 280 tons for all CEECs, i.e. 0,77% of 2003 EU beef meat consumption).

¹⁰. EU imports of sensitive products commonly occur within TRQs, which allow some amount of imports at a tariff far enough below the MFN rate to facilitate trade. On additional imports, a tariff up to the MFN rate may be applied. Although the GATT bans absolute quotas, the EU's prohibitive MFN tariffs still effectively limit trade to the TRQ amount, achieving the same result. While the EU's commitments to GATT required the EU to establish 87 TRQs, WTO data indicate that the EU actually has some 257 tariff lines under TRQs.

¹¹ Africa, Caribbean and Pacific countries (71 members).

¹². These quotas have been the subject of successive WTO disputes and TRQs will be eliminated when a tariff-only regime for banana imports is introduced not later than 1 January, 2006.

MARKET ACCESS RULES IN RECENTLY CONCLUDED PREFERENTIAL TRADE ARRANGEMENTS

Within the EU-Morocco agreement on agricultural trade liberalization signed in 2003 (which is part of the so-called Barcelona process for integration between the EU and the countries of the Mediterranean basin, which includes a call for gradual liberalization of agricultural trade), Morocco has gained an increased TRQ for tomato exports to the EU. Within the EU-Lebanon association agreement signed one year before, the EU offered full liberalization (no duty, no quota) for all Lebanese agricultural products, with a list of exceptions covering sensitive areas of EU domestic agriculture (potatoes, tomatoes, garlic, olives, citrus, table grapes, pears, apples and wine) for which individual zero duty tariff quotas, with an annual increase, have been set.

The EU-South Africa FTA was signed in 1999. Its trade chapter provides for a gradual establishment of a FTA: the EU has 10 years to abolish all restrictions on 95% of South African exports and South Africa has 12 years to liberalized 86% of the EU's exports. The 5% exclusion on the EU side is all agriculture, including traded and sensitive products (fruits and vegetables) and non-traded but potentially sensitive products (sugar, beef, etc.).

Within the EU-Chile Agreement signed in 2002, customs duties on a list of agricultural and processed agricultural imports originating in Chile shall be eliminated in accordance with a long term timetable (up to January 2013). For some sensitive products included in the list, for which the Common Customs Tariff provides for the application of an *ad valorem* customs duty and a specific customs duty, the tariff elimination shall only apply to the *ad valorem* customs duty. The most sensitive agricultural products do not benefit from tariff reductions. The Community allows duty free TRQs for these products with an increase of 10% each year of the original quantity. Furthermore, tariff concessions do not apply to imports into the Community of products originating in Chile and covered by denominations protected in the EU. Summing up, for most of the CAP protected products, liberalization has been provided only within tariff quotas.

1.3 Impact on Trade of EU Enlargement.

With the enlargement of the EU changes in European agriculture and trade patterns are expected. A number of analyses have been conducted on the impact of enlargement on agricultural markets in the EU. The most recent of these (European Commission, 2003) estimates that cereals and beef exports of the EU (including the 10 CEECs) would increase, with a growing share of

these exports coming from the new members. Oilseed imports to the enlarged EU would rise slightly as all import tariffs go to zero. Butter and cheese exports are expected to increase, with both old and new members contributing. Poultry production and exports shift from the EU-15 to the CEEC-10 and the opposite is projected to happen for pig meat, with both slightly declining in exports as a result of enlargement. Most of these likely changes are not too surprising, given the changes in border protection and in market support measures. In addition, most of the Candidate Members have population densities below the EU average and likely a comparative advantage in more extensive production activities. The poultry result is not so intuitive, given that poultry is currently relatively more highly protected and not as technically advanced in most Candidate Members.

As regards tariff changes, various analyses indicate that for most commodities tariff rates will increase when new Member States will adopt EU border protection measures. The share of CEEC imports that come from the South American bloc can indicate the potential impact of these adjustments on Mercosur agricultural exports. For the ten countries expected to join the EU single market in 2004 or later, current agricultural imports from Mercosur countries are still relatively limited. However, imports from Brazil or Argentina have grown up on the very last years. For the Brazilian sugar, beef meat and pig meat sectors some CEECs are already significant export markets. Moreover, one must not underestimate the potential growth of CEECs imports in the future.

To assess the impact of the EU enlargement on third countries exports, some studies have considered current applied tariff rates in the applicant countries to see how far they will have to adjust upon joining the EU. These comparisons are done by looking at the relatively more sensitive and usually often traded commodities. The tariff rate evaluation is made from the main traded items (such as frozen carcasses in the case of meat). Admittedly, these studies overlook some exported commodities important for Mercosur (such as fresh and processed fruits) but nonetheless they permit an evaluation of the enlargement main issues for the South-American Customs Union. They show that most applicant countries (except Poland) will have substantial increases in tariff rates when full members of the EU, for example in the cereals sector. For oilseeds and oil-meals, two applicant countries (Poland and the Czech Republic) that have non-zero tariffs will see rates fall to zero. For white sugar, tariffs in Slovenia and Romania are low relative to the rest of the CEECs and the EU. For beef products, tariff rates in the EU are generally higher than tariffs in the CEECs. In this sector too, most countries will have substantial increases in tariff rates when EU members. In most CEECs there is no difference between tariff rates on carcasses and semi-processed products like boneless beef. For pork carcasses, most countries are relatively close to EU rates, but Poland and Hungary will have substantial reductions. All Candidate Countries, except Slovenia, will experience substantial reductions in poultry tariff rates.

In the cases where import tariffs will rise with respect to third countries, imports from the world markets will probably be replaced by imports from the enlarged single European market. In fact, these trade diversion impact already began, in part with the preferential trade arrangements within the framework of Europe Agreements each Candidate Country have with the EU, including the double-zero lists. But those were relatively limited in scope. One way to view the potential magnitude of this trade diversion is to consider the potential of growth of consumption in applicant countries.

NEGOTIATIONS WITH TRADING PARTNERS FOR COMPENSATION UNDER GATT ARTICLE XXIV 5 AND 6.

The original GATT Article XXIV 5 and 6, complemented by the *Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994* require that when a customs union is formed or enlarged, the resultant level of external trade protection must not be greater than the previous level in the constituent members, taken together. If protection is increased, compensation in the form of tariff reductions or other improved market access mechanisms must be negotiated with other WTO trading partners, which are adversely affected by the increase.

Negotiations with other GATT trading partners for compensation under Article XXIV 6 took place in the past after each enlargement. Such negotiations lasted for several years after the accession of Spain and Portugal in 1986. On recent years efforts are being made to avoid a new long and complex negotiation. The candidate countries' tariffs have been aligned as far as possible on the EU tariff before accession. Their trade policies and procedures have been coordinated with those of the Community in advance. In this context, the first-wave accessions will not create difficult problems of trade compensation under WTO rules, except for very sensitive agricultural sector.

II. Agricultural Sensitive Products in the EU-Mercosur Negotiations

For the purpose of the negotiation, the EU and Mercosur have presented different proposals for tariff elimination. On the one hand, Mercosur opted for a "less than full reciprocity" approach. According to this proposal, Mercosur imports from the EU would be subject to the following categories of tariff reduction: A- 0 years, B-8 years and C, D, E - 10 years, knowing that mentioned categories would be subject to different levels of reduction. However, Mercosur proposed a different schedule for EU imports from Mercosur, which would have four categories for tariff reduction: A-0 years, B-4 years, C-7years and D-10 years. The current offer from Mercosur still presents a number of products that are not classified in the mentioned categories.

On the other hand, the EU has selected a list of 2139 agricultural products tariff lines. Products have been distributed in five categories (from A to E), which should determine tariff reduction periods for both imports from

Mercosur and from the EU: A- 0 years, B- 4 years, C- 7 years, D- 10 years and E- not defined. For the EU, the category "E" is a special schedule for a large range of agricultural and processed products, for which tariffs elimination applies only to ad-valorem duties.

From all selected agricultural products to be negotiated, the EU allocated 939 lines (43.9% from the total tariff lines) in the category "E". So, when analyzing the EU proposal, it is important to note that the main export products from Mercosur, including meat (bovine, poultry and pork) and sugar, were allocated in the list "E", being most of them subject to TRQs.

Concerning products included by the EU in category "E", Mercosur proposes to re-classify a "substantial number" of these tariff lines into other categories of tariffs reduction. The remaining products should benefit from a significant tariff reduction or receive special TRQs on a case by case basis in order to ensure substantial and effective market access for exports from Mercosur.

Another important component of the EU position regarding this negotiation is the proposal of a "two-step approach" which means that the EU would offer preferential access to Mercosur sensitive agricultural products through the concession of additional TRQs in two phases. This means that in a "first step" the EU would grant to Mercosur the right to export an additional but limited quantity of product "X" in the framework of the EU-Mercosur agreement. Then, Mercosur would receive in a second step an exclusive percentage of the global offer to be made by the EU to third countries for product "X" in the multilateral round of Doha.

TRQs administration is also an issue to be negotiated. Since some quotas are controlled by importers, it will be important to observe which are the pros and cons of quotas administration methods for each analyzed products in order to see how this can affect trade flows between the EU and Mercosur.

Among all products under negotiation between the EU and Mercosur, some of them ought to be analyzed separately. These products have been classified as "sensitive" because of their importance in EU-Mercosur trade flows as well as of the level of restrictions they face.

With the objective of providing feasible solutions to untie the "agriculture knot" in the EU-Mercosur negotiations, this study has identified the 11 products that can be classified as "sensitive" for Mercosur. These products are: meat (bovine, pork and poultry), sugar, ethanol, tobacco, powder milk, corn, wheat, orange juice and fruits.

Table 3
EU production, consumption and EU-Mercosur trade flows in 2002

1000 T	Mercosur exports to the world	EU imports from the world	EU imports from Mercosur	EU production	EU consumption
Bovine meat	1,613.0	519.0	397.0	7,408.0	7,552.5
Pork meat	590.0	65.0	0.0	17,825.0	16,666.0
Poultry meat	1,595.0	395.5	230.7	6,850.0	6,410.0
Sugar	13,609.1	2,025.0	57.4	16,153.0	14,088.0
Fuel ethanol*	218.3	86.7	86.7	174.6	261.3
Tobacco	559.0	491.7	128.7	n.a.	n.a.
Powder milk	141.0	87.0	0.0	1,070.0	838.0
Corn	12,544.9	2,715.4	1,799.1	39,450.0	40,800.0
Wheat	9,130.6	12,921.0	51.3	103,894.0	97,100.0
Orange juice	1,055.0	895.5	686.6	n.a.	n.a.

Notes:

1. Ethanol volumes are expressed in million liters. EU imports from the world represent Brazilian exports to the EU according to 2003 statistics.
2. Corn trade flows data refers to corn in grains, but not for seeding.
3. Wheat trade flows do not include *durum* wheat.
4. Brazilian exports of orange juice represent 99% of total Mercosur exports for this product.

*Volumes in mn liters. Numbers of 2003.

Sources: COMEXT, DataIntal and FAS/USDA

Agricultural products represent around 29 billion dollars of Mercosur exports, of which 35% are exported to the EU. However, Table 3 shows that some of the selected products exported by Mercosur have a very small access to the EU domestic market. Sugar imports from Mercosur lead the ranking: while Mercosur is the first sugar exporter in the world, its exports to the EU represent only 0.4% of total EU sugar consumption.

Even though Mercosur countries – mainly Brazil and Argentina - are net exporters of bovine and poultry meat, imports from these countries represent only 5% and 4% of EU consumption, respectively. These numbers can be explained, in part, by the high import duties charged by the EU for these products, as shown in Table 4. TRQs available to Mercosur products have a very limited capacity, compared to the potential exports from this bloc to the EU. Thus, a significant proportion of Mercosur exports are entering the EU out-of-quota, and face, therefore, very high tariffs. Over-quota tariffs can reach prohibitive levels in the case of sugar and restrictive levels in the case of meat and cereals.

Another important information displayed in Table 4 is the list of offers proposed by the EU, in which the main Mercosur export products are allocated in the category "E", showing their sensibility in the bi-regional negotiations.

Table 4
EU tariffs, TRQs and SSGs on sensitive agricultural products

	MFN tariffs		In-quota tariffs		TRQs	SSGs	EU Offer
	From	To	From	To	Existence of TRQs	Application of Special Safeguards	Elimination Schedule
Bovine meat	98.2 %	176.7 %	20.0 %	135.2 %	x	x	E
Pork meat	0.0 %	40.4 %	0.0 %	20.2 %	x	x	E
Poultry meat	93.1 %	94.5 %	0.0 %	73.4 %	x	x	E
Sugar	138.3 %	198.8 %	0.0 %	46.5 %	x	x	E
Ethanol	18.2 %	46.7 %	-	-	-		E
Tobacco	26.5 %	108.6 %	-	-	-		D
Powder milk	62.9 %	91.8 %	-	-	-	x	E
Corn	84.9 %	84.9 %	45.2 %	45.2 %	x	x	E
Wheat	71.2 %	71.2 %	0.0 %	0.0 %	x		E
Orange juice	12.2 %	15.2 %	-	-			D
Fruits	2.4 %	210.9 %	0.0 %	23.3 %	X		All categories*

Notes:

1. MFN tariffs are duties applied for products exported over-quota. In-quota tariffs are duties applied on products imported under the quota regime.

2. Table contains only the main tariff lines exported from Mercosur to the EU.

3. EU offer: A-0 years, B-4 years, C-7 years, D-10 years and E-not defined.

* Classification depends on the fruit.

Sources: CAP Monitor, European Commission and Institute for International Trade Negotiations - ICONTE

Because negotiations are usually deadlocked in particular sectors, which are very competitive for Mercosur exports and, thus, very protected by the EU import regime, a feasible agreement should be based on a product by product analysis. Some of the selected products are mostly protected through high tariffs and limited TRQs, so a product by product analysis should be carried out concentrating on strategic products that will probably shape the results of EU-Mercosur negotiations. For each of these sensitive products we present the most radical positions available in each of the blocs. The positions have been elaborated based on official statements and interviews made with government officers as well as with agriculture and agri-business private sector associations in Brazil and in France.

2.1 Bovine Meat

EU domestic consumption of bovine meat has grown 10% in the year 2001/2002, recovering from the BSE¹³ crisis which caused a significant reduction in the bovine meat production and consumption numbers in the EU. In 2002, 5,481 thousand tons were consumed in the EU, representing an additional 3% compared to 2000 pre-BSE crisis level.

Imports from third countries remained stable after the establishment of the URAA. Currently they represent around 6.9% of the EU domestic consumption of which 5% are originated from Mercosur countries, mainly Brazil and Argentina.

Mercosur is a net exporter of bovine meat. However, access to the EU market is provided by a complex system of import quotas, which is the result of different agreements: GATT, Lomé and Cotonou and association agreements with Eastern European countries.

Some quotas with special tariff rates of 20% *ad valorem* are offered for bovine meat imported from Mercosur countries. However, in-quota tariff rates for frozen bovine meat have additional specific duties due to applied administration methods, as shown in Table 5.

Table 5
Tariffs and TRQs for bovine meat exports from Mercosur (2002/03)

1000 tons	Country	Total quota volume available	In-quota exports	Over-quota exports	Other ³	In-quota tariffs	Over-quota tariffs
Frozen	Brazil	53 (GATT) + 38.5 (Reg. A and B) ¹	73.1	5.4	2.2	20 % + 2,000 €/ton for licensing (GATT) 20 % + 2,138.4 €/ton (ITQ-Regime B) 20 % (ITQ – Regime A)	12.8% + 3,041€/ton or 176.7 % (AVE)
	Argentina		11.7	3.6	1.1		
	Uruguay		7.2	3.7	1.1		
	Paraguay		0.0	0.5	0.0		
	Mercosur		92.0	13.2	4.4		
Fresh or chilled	Brazil	65.6 (Hilton beef) ²	5.0	41.2	-	20 %	12.8% + 3,034€/ton or 98.2 % (AVE)
	Argentina		38.0	5.7	-		
	Uruguay		6.3	1.5	-		
	Paraguay		0.0	0.0	-		
	Mercosur		49.3	48.4	-		

Notes:

1. Frozen Beef quotas are distributed through historical allocation and are, therefore, currently and totally covered by Mercosur countries.
2. Hilton quota was established in 69,100 tons for the agricultural year 2003/2004.

¹³. Bovine Spongiform Encephalopathy.

Notes (continued)

3. A volume of 4,400 tons of frozen bovine meat imports originating in Mercosur is exported under the frozen meat quota regime. A major part of these imports are aimed at supplying foreign diplomatic missions in the EU member countries. Under this scheme, Brazil exports 2,200 tons, Argentina 1,100 tons and Uruguay 1,100 tons.
Sources: COMEXT, WTO, TARIC, Brazilian Ministry of Industry, Development and Foreign Trade

Quotas available for Mercosur bovine meat exports are quite limited compared to the bovine meat export potential of the bloc. Besides, the existing quotas are not available to the Mercosur as whole, which means that these preferences are distributed individually to each country. It is possible to classify at least three import quota regimes, established under the WTO Agreement, which are available to Mercosur countries¹⁴:

- 53,000 tons (GATT Quota) of frozen bovine meat being imported under a 20% *ad valorem* duty. This quota is mostly covered by Brazil (44,000 tons), Argentina (6,000 tons) and Uruguay (3,000 tons) and is distributed among importers based on the historical allocation method.
- 38,500 tons (Individual Tariff Quota - ITQ) are offered to frozen beef imports intended for processing in the EU and are totally covered by Mercosur exports. This quota is divided into two different regimes (A and B), depending on the final product (A-products or B-products) that will result from this import. Thus a different tariff is applied for each regime: imports under regime A must pay a 20% *ad-valorem* duty while imports under regime B are supposed to pay the same 20% duty plus a specific rate of €2,138.4 per ton. Of the total volume of this quota, Brazil exports around 28,100 tons, Argentina 6,000 tons and Uruguay 4,400 tons.
- 69,100 tons (Hilton Quota)¹⁵ are offered for high quality meat imports (Hilton beef). This is the only beef quota which is distributed among exporters who are responsible for its fulfillment. License certificates are conceded to importers on a "license on demand" basis. This quota is divided among 10 meat export countries, of which 5,000 tons are offered to Brazil, 38,000 to Argentina, 6,300 to Uruguay and 1,000 tons to Paraguay. Under Hilton quota, Mercosur countries export 49,300 tons together since Paraguay does not use its 1,000 tons quota. The other 19,800 tons are offered to the US and Canada (11,500 tons), Australia (7,000 tons) and New Zealand (300 tons). It is important to remark that the quota offered to meat originating from the US and Canada is not fulfilled due to the high level of hormones incorporated in the meat.

Table 5 shows that considerable improvements can be carried out regarding market access for bovine meat. An over-quota tariff of 176.7%

¹⁴. All volume measures shown in Carcasse Weight Equivalent (CWE).

¹⁵ Since 2003, this Hilton quota was increased to 69,100 tons. Before this period, an amount of 65,600 tons was available under Hilton quota.

(calculated in % AVE)¹⁶ is currently blocking Mercosur access to the EU frozen beef market. It is also important to take into account that even in-quota exports that face lower tariffs of 20%, suffer from additional specific charges imposed regarding the quota license (€2,000/MT for GATT quota). The quota license payment occurs under an existing "quota market" among importers who can sell their quotas if they are not going to use them. However, the charge is paid by exporters.

Concerning high quality bovine meat, Table 5 shows that, current quotas available for each Mercosur country are very small for Brazil while Paraguay, for instance, does not use its quota due to the country's Foot and Mouth disease problems. Brazil receives only a 5,000 tons quota while exporting 46,200 tons of high quality meat to the EU. On the other hand, Paraguay receives a 1,000 tons quota that is not used. Argentina and Uruguay are filling their quotas and exporting 5,700 tons and 1,500 tons over-quota, respectively.

Other EU Preferences to Third Countries

Preferences given to third countries, besides Mercosur's, are another concern that should be taken into consideration. Bovine meat quotas with preferential tariff rates are offered to ACP countries and to Associated Eastern European countries, but they are not filled.

Table 6
Main preferences for EU
imports of bovine meat in 2002

Tons	Total Beef exports to the EU	Total quotas offered	Annual increase	In-quota Tariffs
ACP Countries	18,955	52,100	0	92 % less than MFN tariffs
EU applicant countries	18,776	47,070	3	80 % less than MFN tariffs

Sources: CAP Monitor 2003/2004 and FAS/USDA

ACP countries receive a total quota of 52,100 tons, under which they can export bovine meat to the EU paying a tariff 92% lower than the MNF tariff applied. This quota is distributed to Botswana (18,916 tons), Kenya (142 tons), Madagascar (7,579 tons), Namibia (13,000 tons), Swaziland (3,363 tons) and Zimbabwe (9,100 tons). Most exports from these countries are originated in Namibia, Botswana and Zimbabwe. However, according to 2002

¹⁶ *Ad Valorem* Equivalent (AVE) tariffs have been calculated as follow: first, an international reference price was adopted based on COMTRADE data, then the value of the tariff was converted into US dollars considering FED's exchange rates for 2002. Finally, tariff value was divided by the reference price adopted. The maximum possible protection was considered.

statistics¹⁷, exports to the EU did not exceed 7,000 tons in any of these countries, and represented less than 1,000 tons in the other ACP benefited countries.

Regarding the EU ten Candidate Members from Eastern Europe, an Association Agreement gives them a total quota of 47,070 tons, which is distributed between Hungary (15,020 tons), Poland (19,200 tons), the Czech Republic (3,500 tons), Slovakia (3,500 tons), Romania (4,000 tons) and Bulgaria (250 tons). The mentioned quotas allow imports from Eastern European countries under tariff rates 80% lower than MNF tariffs. Likewise in the ACP countries case, these quotas are not fulfilled. Poland is the major exporter filling 86% of its quota. Hungary comes in second, exporting 3,770 tons, which represent only 25% of its quota. A special mention has to be made regarding the preferences granted to the Candidate Members: an annual increase of 1,365 and 1,600 tons is provided for Hungary and Poland respectively from the year 2003 on.

Besides ACP and Candidate Members' schemes, a 10,500 tons quota is offered to Slovenia. A 3,775 tons quota with an annual increase of 625 tons is also granted to the Baltic States.

Enlargement

According to the European Commission provisions, opportunities in the bovine meat market are projected to grow with enlargement. With the accession of 10 new members, it is expected that bovine meat demand will increase in the EU-25. Even though the European Commission calculates that consumption of bovine meat in newly acceded members will decrease by 2% until 2009, production numbers are expected to have a greater reduction of 20%. This scenario is caused mostly by the recent intensification of collective farms privatization, the private farms lack of capital and the intensification of milk production. Therefore, new market shares will be available to fulfill this production deficit. The European Commission calculates that 214,000 tons will be needed to supply new members¹⁸.

¹⁷. United States Department of Agriculture, USDA.

¹⁸. CHATELLIER, Vincent, GUYOMARD, Hervé, LE BRIS, Katell. *Production Bovine: entre économie de marché et politique de territoire*. Déméter 2004. Armand Colin, Paris, 2003. (p67-179).

Suggestions for discussion on bovine meat in the EU-Mercosur negotiations

In the EU-Mercosur negotiation context, the Brazilian position on possible improvements of access of bovine meat to the EU is the following:

- Substantial reduction of over-quota tariffs for high quality beef (Hilton) and meat intended for processing, allowing Mercosur to improve its participation in supplying EU's demand.
- The GATT quota is distributed according to the historical performance of the importer (historical allocation). This system generates a "quota market" among importers implying more costs for exporters who are supposed to pay for the quota license of € 2,000/ton. Besides, the "past trading performance" requirement applied to this quota limits the number of companies authorized to import to the EU market. Besides the historical allocation, which concerns the country of origin, the past trading performance concerns the companies of origin.

However, the French position is much more restrictive as regards market access for bovine meats:

- Special TRQs could be created for live bovine animals.
- An increase in imported quantities of Hilton beef could eventually take place through a very small expansion of import-quotas. However, it is excluded to consolidate the traditional trade flows. Therefore, the in-quota import expansion would not reach the level of current in and over-quota imports of bovine meats originating in Mercosur.
- Because of the reform of the EU milk sector, the EU bovine meat offer is expected to grow and the possibility of absorption of extra-EU imports will be reduced.
- Import quotas would be attributed to Mercosur as a bloc.

Other bovine products are excluded from the negotiation.

2.2 Chicken Meat

Poultry is another strategic product for the EU-Mercosur trade negotiations. From the URAA on, poultry imports into the EU grew considerably. Mercosur together with Thailand and the ten EU Candidate Members are the main suppliers of the EU domestic market. Imports from Mercosur represent 58% of total extra-EU imports. In fact, Brazil is the main supplier, accounting for 99% of Mercosur's total exports to the EU.

Table 7
Mercosur chicken meat exports to the EU - 2002

Tons	Exports to the EU	Available quota volume	In-quota exports	Over-quota exports	% of over-quotas exports from total
Brazil	278,355	7,100	7,100	254,300	91 %
Argentina	3,054	0	0	3,054	100 %
Paraguay	0	0	0	0	-
Uruguay	0	0	0	0	-
Mercosur	281,409	7,100	7,100	257,354	91.4 %

Sources: Brazilian Association of Poultry Exporters (ABEF), COMEXT and The Brazilian Ministry of Industry Development and Foreign Trade.

Table 7 presents the volume of poultry exported from Mercosur to the EU. The 2002 numbers show that 91% of all poultry exports are entering the EU market through out-of-quota regime, which implies high tariffs rates applied on 257,354 tons of chicken meat exported by Mercosur.

Table 7 explains the current regimes for poultry imports in the EU. After the Uruguay Round, four TRQs were created for poultry imports:

- 15,500 tons of frozen chicken cuts to compensate the Soybeans Panel. This quota is mostly covered by Brazil (7,100 tons) and Thailand (5,100 tons).
- 6,200 tons of frozen or fresh whole chicken.
- 4,000 tons of frozen or fresh chicken cuts.
- 700 tons of boneless chicken cuts.

From the in-quota preferential scheme, only 7,100 tons are covered by Mercosur (compensation to Brazil regarding the soybeans Panel) and the other imports are being subject to out-of-quota rates, as shown in Table 7. Since Mercosur exports of whole chicken represent only 6% of total chicken exports, the major part of imports from Mercosur have access to the EU market through the payment of a 94.5% (AVE) tariff rate. In 1998/1999, Brazil started to export salted chicken cuts, which were subject to lower tariffs of 15.4%. However, after the publication of the European Commission regulation 1223/2002, salted chicken imports were incorporated into the 0207.14.10 tariff line, which is subject to an out-of-quota tariff of 94.5% (AVE).

TRQs offered for chicken meat are distributed under the "license on demand" method. Nevertheless an additional "past trading performance" requirement may act as a barrier to exports from Mercosur. Likewise for bovine meat, "past trading performance" requirements limit the scope of companies that are allowed to import into the EU.

Table 8
Current tariffs applied on chicken meat imports in the EU

	Specific tariffs		Ad-valorem equivalent (%)	
	In-quota	Over-quota	In-quota	Over-quota
Whole chicken	131 €/ton to 162 €/ton	325 €/ton	8.6 % to 16.5 %	33.1 %
Chicken cuts fresh or frozen	93 €/ton to 512 €/ton	187 €/ton to 1,024 €/ton	5.1 % to 27.9 %	94.5 %
Chicken cuts (Soybean Panel)	0	1,024 €/ton	0	94,5 %
Chicken cuts frozen and boneless	795 €/ton	1,024 €/ton	73.4 %	94.5 %

Note: until the publication of EU Commission regulation 1223/2002, Brazilian exports of salted chicken were subject to a 15.4% tariff rate. From the regulation publication on, this product is subject to the 0207.14.10 tariff line code, which is €1,024 /T.

Source: EU Commission

Special Safeguard Measures (SSG)

The EU applies safeguard measures to some chicken meat exporters, including Brazil. These measures represent an additional duty of around 0.06 euros per kilo on Mercosur exports.

Larger Preferences for Bilateral Agreements

It is important to note that a majority of preferences given for imported chicken meat in the EU are established in bilateral agreements. Besides the 26,400 tons that the EU offers to chicken meat exporters, around 200,000¹⁹ tons are offered to Eastern European countries (Association Agreement), ACP countries, Baltic States and Slovenia. Actually 94% of these quotas are offered to the Eastern European Countries that will join the EU-15. Nevertheless, these countries do not fill the available TRQs. In 2002, their fill rate remained at 58.7%.

In-quota imports from this countries enter the EU duty-free, except for Slovenia imports, for which chicken meat are supposed to pay tariffs ranging from 0 to 20%.

¹⁹. Source: OFIVAL. It includes chicken meat preparations and whole chickens.

***Suggestions for discussion on poultry meat in
the EU-Mercosur negotiations***

The Brazilian position defends the following points:

- A significant reduction of high over-quota tariff rates should be one of the main objectives of a bi-regional FTA.
- Another option would be the establishment of special TRQs provided exclusively to Mercosur with new preferential import regimes.
- If additional TRQs are established, their administration methods should be revised.
- The special safeguards measures by the EU should be negotiated.

The French position is totally opposed to any negotiation regarding market access improvements for chicken meat.

2.3 Pork meat

The EU swine meat production supplies internal demand and is also exported to extra-EU countries. In 2002, EU domestic production reached 17,825 thousand tons while domestic consumption was calculated in 16,666 thousand tons. As a result, 1,194 tons are exported to third countries and only 65 thousand tons are imported from non-EU members to the EU-15²⁰. Thus, total imports from extra-EU countries represent an insignificant part of the EU consumption for this product.

The main suppliers of EU pork meat are East European countries. Likewise for bovine and poultry meat, the EU established a preferential agreement with large import quotas, through which the imports of swine meat take place duty-free. The Candidate Members are, therefore, the EU main trade partners for this sector.

Table 9 shows how large are the quotas offered to Eastern European countries compared to the small quantities available for pork meat imports from the rest of the world.

²⁰. Source: FAS-USDA.

Table 9
Main tariffs and TRQs for pork meat in the EU¹

	Quota volume (1000MT) ²	Specific tariffs		Ad valorem Equivalent	
		In-quota	Over-quota	In-quota	Over-quota
Carcasses	15.0	268 €/ton	536 €/ton	17.1 %	34.3 %
Cuts of swine, fresh or chilled	5.5	233 €/ton to 434 €/ton	778 €/ton to 869 €/ton	22.5 % to 30.8 %	45.1 % to 61.7 %
Loins and cuts	7.0	0 %	467 €/ton to 869 €/ton	0 %	27.9 % to 40.4 %
Boneless loins and hams	34.0	250 €/ton	869 €/ton	10.8 %	40.4 %
Carcasses and cuts of swine, chilled or frozen (CEECs and Baltic States)³	133.1	0	Same tariffs	0 %	Same tariffs

Notes:

1. Volumes established for the agricultural year (from July to June).
2. Does not include TRQs for processed products which totalize 9.100 tons.
3. Only Romania is subject to an in-quota tariff rate of 20%.

Source: CAP Monitor

Trade flows of swine meat between the EU and Mercosur countries are not expressive. Small amounts of 70 thousand tons of processed meat were imported by Argentina in 2002, but nothing was imported by the other Mercosur members since Mercosur's small pork meat production supplies the domestic market in the region.

SPS Requirements

Since Mercosur is considered a risk zone for pork diseases, such as Classical Swine Fever, exports of pork meat into the EU are currently restricted. Even if some Mercosur regions are already considered as free of risk of Classical Swine Fever, imports from these regions would not be allowed since the EU adopts stricter sanitary standards than those established by the International Office of Epizootics (IOE). Therefore, in order to assess the compliance with SPS standards, the EU could apply a region by region method, to be developed as part of the FTA between EU and Mercosur.

Another problem concerning SPS standards for pork meat is the fact that Mercosur does not have an integrated region of pork meat production, which makes traceability requirements a very difficult task to be carried out.

***Suggestions for discussions on pork meat in
the EU-Mercosur negotiations***

According to the Brazilian position:

- The most important point would be the establishment of feasible and secure standards for both EU and Mercosur exports.
- Secondly, preferential schemes should be established in order to facilitate pork meat trade between these two regions.

The French position states that:

- Market access for swine meat could take place through the creation of a special import-quota. However, considering the crisis that pork producers currently face this measure could face high resistance in France.
- SPS issues should be discussed in the corresponding negotiating group and not in the market access negotiations.

2.4 Sugar & Ethyl Alcohol

Sugar and ethanol fuel are two important products to this negotiation because Brazil is Mercosur's traditional producer and exporter of both sugar cane and derived products. Brazil alone produced around 22.5 million tons of sugar in 2002 and exported almost 13.3 million tons in the same period²¹.

In 2002, the EU produced 18.6 million tons of sugar and consumed 14.3 million tons. 5.6 million tons were exported to third countries while extra-EU imports amounted to 2.1 million tons, of which only 57,148 tons were imported from Mercosur²².

Production and exports of sugar in the EU are heavily subsidized.. These domestic policies cause important trade distortions in the international market, affecting prices and artificially competing with more efficient producers, such as Mercosur ones. Besides, some preferences benefit less competitive sugar imports coming from ACP countries. These import preferences are benefiting mostly the large sugar producers in the EU and in ACP countries.

Current sugar exports to the EU take place through a quota regime as shown in Table 10. The majority of sugar imports are originating in ACP countries and India. Mercosur has, through Brazil, the right to export 28% of the "Finland quota" for raw sugar. Table 11 shows, however, that even in-quota small volumes exported from Mercosur through Finland quota are subject to a 98€/Ton tariff rate.

²¹. Source: São Paulo Sugar Cane Agro-industry Union.

²². Sources: COMEXT; FAS/USDA.

Table 10
Sugar imports by the EU - 2003/03 (1000T)

Quotas¹	Volumes (1000 tons)
ACP and India	1,304.7
Finland (for refine) ²	82.0
Special Preferential Sugar ³	229.0
"Everything But Arms" (EBA) ⁴	74.185 (2001/2002)
	197.335 (2008/2009)

Notes:

1. Does not include imported volumes from the Balkans since this quota is suspended.
 2. Brazil has 28% of the Finland quota volume which is distributed only to producers from the northeast region.
 3. The volume of SPS quota is calculated each year by the European Commission. This quota is allocated in ACP countries and India and is currently duty free.
 4. From 2006/07 on tariffs over-quota will be reduced gradually to 0% by 2009/2010.
- Sources: CAP Monitor; European Commission.

For raw sugar, over-quota tariffs reach the "prohibitive" level of 170% (AVE), which makes exports impossible. White sugar import tariffs stand at €419T or 140% (AVE), which can be also classified as "prohibitive". Therefore, considering that sugar is a very competitive export product for Mercosur and that sugar industry is one of the main sectors of the Brazilian agriculture, a plausible scenario for the EU-Mercosur trade negotiations should include significant modifications to the EU sugar import regime.

Table 11
Tariffs, entry prices and guaranteed prices for sugar in the EU

	Tariffs	Guaranteed price	Entry price¹
Raw sugar	Intra-TRQ : 0 % for ACP, Special Preferential Sugar and EBA. 98 €/ton. For Finland sugar quota	523.7 €/ton	Not applied
	Extra-TRQ : 339 €/ton (170 %)		
White sugar	419 €/ton (140 %)	631.9 €/ton	531.0 €/ton
Ethanol	192 €/m ³ (64 %) (denaturated) 102 €/m ³ (undenaturated)	Not applied	Not applied

Note:

1. Special Safeguard measures are applied if CIF import prices fall under entry prices.
- Source: European Commission

Ethanol Fuel

It is also important to consider ethanol fuel as a trade-off in the current negotiations. Fuel ethanol is a popular technology mainly used in the Brazilian and US automotive sector as well as in selected European countries. Production of this fuel in Brazil increased to 14 billion liters in 2002. Producers are thus prepared to supply possible demands from the international market. Still very small, the EU's current demand for ethanol fuel is fulfilled by its internal production, mainly in France and Spain, and small quantities imported by Sweden.

However with the adoption of the recent Directive 2003/30/EC, bio-fuels such as ethanol fuel may be required in the EU since Member States are supposed to comply with a target of adding at least 5.75% of bio-fuels in traditional fuels in the market by the year 2010.

Table 12
Ethanol fuel production and consumption in the EU

Mn liters	2003	2012
Production ¹	174.6	5,100
Consumption ²	254.6	6,000
Imports Extra-EU ³	80.0	900

Notes:

1. Production in 2012 is projected to represent 85% of consumption in the same period.
2. Consumption in 2003 is the result of production plus imports in the same period. In 2012, the scenario predicted expects that EU will fulfill 50% of Biofuel Directive objectives with ethanol fuel.
3. EU imports in 2003 represent Brazilian exports to Sweden. In 2012, consumption is calculated by the difference between production and consumption.

Sources: European Commission; Brazilian Ministry of Industry Development and Foreign Trade; ICONE.

Thus, as shown in Table 12, some projections present positive figures for the expansion of the ethanol fuel market. Nowadays, Mercosur ethanol exports would have difficult access to the EU market since a high tariff of 102€/m³ is charged turning the product less attractive than traditional fuels.

Suggestions for discussions on sugar and ethanol in the EU-Mercosur negotiations

The Brazilian proposal entails the following measures:

- Substantive reduction of sugar import tariffs with the objective of making exports from Mercosur possible.
- Creation of special preferences for sugar originating from Mercosur.
- Reduction of import tariffs for ethanol.

The French position is categorical: sugar and ethanol are excluded from the negotiations. Many arguments are put forwards to defend this position, such as:

- Sugar cannot be negotiated before the reform of the EU sugar common market.
- Sugar has not been liberalized under the Mercosur agreement. It is therefore unconceivable to negotiate this product with third parties.
- There is no current demand for ethanol in the EU. It is not possible to grant trade concessions for a market that does not exist. In addition, EU ethanol production needs to be protected to have a chance to develop. Ethanol trade liberalization could be reevaluated once ethanol demand and production in the EU would be significant.

2.5 Fruits

Access to the fruits market could be considerably improved in the EU-Mercosur negotiation. EU imports from Mercosur represent 11% of total EU imports from third countries²³. Despite the market access difficulties for the main Mercosur's exportable fruits in the EU, Table 13 shows that elimination of customs duties is seriously considered in the EU-Mercosur talks. Bananas and oranges, however, seem to be the more sensitive products of this sector. Special attention should be paid to bananas since exporters face a prohibitive tariff of 210% (AVE).

²³ Source: COMEXT. This includes bananas, oranges, lemons, grapes, apples, pears and apricots.

Table 13
Tariffs, TRQs and offers for main Mercosur export fruits

Products	Tariffs	Quotas	EU offer
Apples¹	11.2 % + 23.8 €/ton	600 tons	A
Pears¹	10.4 % + 23.8 €/ton	1,000 tons (5 % less than MFN tariff)	B
Bananas	680 €/ton 210 % (AVE)	2,200,000 tons 75 €/ton	E
Oranges¹	6.4 % + 256 €/ton 34.1 % (AVE)	20,000 tons (10 %)	D
Grapes¹	27.6 %	1,500 tons	C

Note:

1. Entry prices

Source: European Commission

SPS Requirements

Both parties should take into consideration the current SPS treatment given to fruit exports from Mercosur. Very strict limits regarding the presence of pesticides and other residues on the peel of exported fruits have been established by the EU. However, some fruits, such as bananas, oranges and papayas, should not be restricted by these rules since the eatable part of the fruit is protected by its peel. Therefore, talks between both parties should include proposals on the facilitation of fruits trade by revising some SPS rules, which are sometimes not necessary.

2.6 Orange Juice

Orange juice is not a product that may threaten or deadlock the results of the EU-Mercosur negotiations. However, it can be considered as a sensitive product if Mercosur's orange juice export potential and the current EU offer for tariff reduction.

Almost the totality (99%) of orange juice imports of orange juice from Mercosur come from Brazil and represent 75% of EU orange juice imports from third countries²⁴. Mercosur exported orange juice tariff lines (concentrated juice with Brix value >20 <67), are charged with duties of 15.2% and 12.2% are charged²⁵.

In the context of the EU-Mercosur trade negotiations, the EU offer allocated frozen and concentrated orange juice in category "D", which means that it will take 10 years to achieve a full liberalization level. The Brazilian and the French position get closer on this topic. In the Brazilian's views, current

²⁴ Source: COMEXT

²⁵ Source: European Commission.

talks should establish a better category for this product regarding its importance in both EU and Mercosur markets. On its side, France is not opposed to a gradual liberalization of orange juice imports through the creation of import-quotas.

2.7 Dairy products

Even though 15% of Mercosur total exports of dairy products to the world are sold in the EU market, Mercosur exports of dairy products to the EU are very limited, accounting for less than 1% of total agricultural exports from the bloc to the EU. Milk and milk-products account only for 0.70% of Mercosur dairy exports to the EU.

TABLE 14
Mercosur selected dairy exports – 2002

	Share in total dairies exports to the world	Share in total dairies exports to the EU
Milk powder	49%	0.15%
Cheese	14.6%	0.5%
Butter	4%	0%

Source : DataIntal

As shown in Table 14, the difference between Mercosur dairy products export performance to the world and to the EU is particularly striking for cheese and milk powder and it illustrates Mercosur interests in securing a more favorable access to the EU market for these products. These trade figures can be partly explained by the level of protection imposed by the EU according to the products. For instance, the EU tariff duty milk powder and cheese oscillate between 71% and 74% and between 24% and 47% respectively. Tariffs applied to these products can reach 91%.

Besides the imposition of high tariffs, many milk products are also subject to TRQs when imported in the EU. Mercosur receives no country-specific quota, it only benefits from the GATT quota granted to third countries. Table 15 shows that in-quota tariffs for Mercosur products are much higher than those applied to CEECs or to ACP countries. Edam is the main cheese exported by Mercosur countries to the EU. No specific volume of import has been allocated to this product; Edam imports take place through a TRQ of 19,100 tons opened to 36 cheese tariff lines. An over-quota of 47.5% AVE is currently imposed on over-quota imports of Edam. In the framework of bilateral trade agreements, the EU has also granted preferential TRQs to selected partners, such as Switzerland and Norway.

The quotas administration method for dairy products is license on demand. However, operators must be approved before they ask for import licenses; this implies the existence of past trading performance. Licenses are

transferable once to avoid the accumulation of unused licenses which are not redistributed.

EU imports of dairy products are also subject to numerous and stringent SPS requirements that are often difficult to meet for third countries. Because national standards may be more demanding than international standards (if it is scientifically justified), in many cases the EU sets standards that are higher than, or are not considered in international provisions. This is the case for animal welfare and traceability process for instance. As regards, milk and milk products, SPS measures range from the maximum level of contaminants authorized in milk products to specific packaging requirements to plants approval by EU authorities.

TABLE 15
Tariffs and TRQs for selected milk products to the EU

		Tariffs	Quotas (tons)¹
Skimmed milk powder		In-quota	
	Third countries	47.5€/100kg	68,000
	CEECs	0% ²	51,015
	ACPs	65% less than MFN tariffs	1,000
	ALL countries	Over-quota 118.8€/100kg	
Butter		In-quota	
	Third countries	94.8€/100kg	10,000
	CEECs	0%	21,615
	ACPs	86.88€/100kg	76,667
	ALL countries	Over-quota 189.6€/100kg to 231.3€/100kg	
Cheese		In-quota³	
	Third countries	13€/100kg to 106.4€/100kg	83,400
	CEECs	0%	51,165
	ACPs	65% less than MFN tariffs	1,000
	ALL countries	Over-quota 139.1€/100kg to 221.2€/100kg	

Notes:

1. Quotas may be divided in sub-categories of the product.

2. Imports from Slovenia are subject to a 20% tariff.

3. Some of the cheese products imports are not subject to TRQs. The MFN tariff rates they face vary between 6.58€/100kg and 221.2€/100kg

Source: European Commission

Export subsidies are another trade policy instrument that affects international trade of milk and milk-products. Dairy is the EU agricultural category that receives the highest level of export refunds, reaching 1,156.9 millions of euros in 2002 (33.7% of total EU agricultural export refunds). Even

though the reduction of EU export refunds for dairies is scheduled, if Mercosur countries liberalize trade in milk products they could face a surge in some EU dairies imports.

Suggestions for discussion on milk and milk products in the EU-Mercosur negotiations

In the EU-Mercosur negotiation context, the position of Brazil and Argentina possible improvements of access of dairy products to the EU is the following:

- Reduction of in and over-quota tariffs.
- Creation of exclusive preferential quotas for Mercosur for powder milk, butter and cheese.
- Revision of TRQ administration methods.
- Establishment of special safeguards to neutralize the intra-bloc effects of EU export subsidies.

On the contrary, the French position as regards trade liberalization of dairy products is much more limited:

- Powder milk should be totally excluded from the negotiation
- Trade liberalization for butter and cheese could take place in the framework of small quotas.

2.8 Cereals

Maize

Mercosur is a major maize supplier of the EU with exports accounting for 66% of total extra-EU maize imports²⁶.

Two quotas are offered for maize imports into the EU: 2,000,000 tons and 500,000 tons. The first one is available for exports to Spain and will be reduced by any quantity of grain substitutes imported into Spain in the same year. The second one is available for imports into Portugal. Quotas administration is made through "license and demand" criteria, but a requirement of "past trading performance" is also applied, which benefits the importer²⁷.

In quota tariffs applied are of 45.2 % (AVE) and over-quota duties are calculated in 84.9% (AVE), representing important restriction to imports. The EU negotiating offer places maize in the category "E" while Mercosur allocates the same product in category "C".

²⁶ Source: COMEXT

²⁷ Source: European Commission

Wheat

The EU wheat production is superior to domestic consumption. However, because the EU does not produce in sufficient quantities all the types of wheat demanded by its internal market, the region also imports wheat from third countries. These imports reached 12.9 million tons in 2002. Although Mercosur exports 9.1 million tons of wheat²⁸ to the world, its share in the extra-EU imports is minor (0,4%).

For extra-EU high quality wheat imports, a very small quota of 300,000 tons is offered at zero import duty. However, over-quota tariffs may reach 75.1% (AVE). Besides "past trading performance" is also required for wheat imports. As regards medium and low quality wheat a maximum annual TRQ of 2,981,600 tons is open. A country-specific quota of 572,000 tons is earmarked for imports originating in the US and 38,000 tons for those originating in Canada. The remainder is split into four equal segments of 592,000 tons each on a quarterly basis, open to other third countries on a first come first served basis. The duty inside the quota is set at 12 €/ton, while over-quota imports are subject to a tariff of €95/ton.

²⁸ Source: European Commission

***Suggestions for discussion on cereals in
the EU-Mercosur negotiations***

As regards maize trade liberalization, Brazil and Argentina have a strong interest in improving market access to the EU since both are major world players in maize production. The following measures are suggested:

- Significant reduction of high import tariffs applied by the EU
- Special preferences granted to Mercosur

The French position on market access for maize is very cautious and tends toward the exclusion of this product. Two reasons can be put forward.

- First, the gap between Mercosur maize costs of production and the EU production costs is larger than for any other important cereal.
- Second, trade liberalization in the maize sector would have dramatic consequences on other EU sectors, mainly the wheat sector. Contrary to the situation prevailing in many countries, wheat – and not maize – is massively used for animal feeding purposes in the EU. If Mercosur maize exports, which are cheap, could enter the EU market duty-free, wheat would be substituted by Mercosur maize imports for animal feeding. As a result, both the EU maize and wheat production – that are less competitive than Mercosur's – would be dramatically affected.
- However, a small margin of negotiation could exist for the opening of limited import-quotas for some types of maize used in the transformation industry (maize starches and meals).

Argentina, more than Brazil, is really interested in the trade liberalization of wheat. Actually Argentina ranks 5 in the list of the top world wheat exporters. Argentina advocates the following measures:

- Establishment of special TRQs provided exclusively to Mercosur with new preferential import regimes.
- If additional TRQs are established, their administration methods should be revised.

The French position refuses any concession in the wheat sector.

2.9 EU Offensive Interests in the Agricultural Sector

Wines, Whiskeys and Other Alcoholic Beverages

Although EU exports of agricultural products to Mercosur are not significant, the EU has some offensive interests in opening market access for transformed products for which external demand stands in the European tradition and "*savoir faire*". Spirituous beverages have an important role in the EU trade balance since they are responsible for 5.5 billion euros of EU's exports to third countries, featuring a positive trade balance of 45 billion euros for this block. Moreover, production of spirits drink involves more than 1.6 billion liters of wine, 2 million tons of cereals and 2.5 million tons of sugar beet and 300,000 tons of fruits²⁹.

With exports to Mercosur amounting to approximately 139 million euros in 2002, the wines and spirits trade balance is clearly positive for the EU and this sector represents 20% of EU agricultural exports to Mercosur. Despite being a very important sector in the EU trade with third countries, wine and spirit industries are undergoing through an economic crisis. Thus, the establishment of a FTA with significant improvement in market access for this sector is of great interest of the EU. Mercosur is currently imposing a 20% *ad valorem* tariff on these products³⁰ and did not classify this product in any tariff reduction category concerning the bi-regional negotiation. EU imports compete with Mercosur domestic production, besides lower priced imports coming from Mercosur associated countries, such as Chile.

Both parties are currently negotiating an agreement on wines and spirits that will address issues such as geographical indications and oenological practices. The EU insistence on geographical indications reflects longstanding grievances among European agricultural producers, who complain that competitors in other countries have effectively stolen many of names and applied them to their own products. The wine trade is especially rife with this practice, with European names such as Bordeaux, Burgundy, Chablis, Champagne and Porto used freely by producers in other countries to promote the sale of wines produced thousands of miles away from the regions that their appellation designate.

Geographical indications are protected at the multilateral level in the WTO TRIPS³¹ agreement. All products are covered by Article 22 of this agreement, which defines a standard level of protection. This says geographical indications have to be protected in order to avoid misleading the public and to prevent unfair competition. Article 23 provides a higher or enhanced level of protection for geographical indications for wines and spirits (subject to a number of exceptions, they have to be protected even if misuse

²⁹ Source: European Confederation of Spirits Producers.

³⁰ Table wines are an exception of Mercosur Common External Tariff. In Brazil, they are subject to a 27% import tariff.

³¹ TRIPS: trade-related aspects of intellectual property rights.

would not cause the public to be misled). Among the exceptions that the agreement allows are: when a name has become a common (or "generic") term and when a term has already been registered as a trademark.

In the framework of the EU-Mercosur negotiations, the EU proposes a greater protection for geographical indications than the provisions provided by the TRIPS agreement. The EU proposal suggests eliminating the exceptions (generic, semi-generic, homonyms and trademarks) made by the TRIPS agreement on wines and spirits. However, this agreement has been incorporated into the legislation of the four Mercosur countries. The exceptions constitute therefore a property right granted by law. The cancellation of trademarks will create a legal problem in Mercosur because trademark holders have a private right. They could claim for economic compensation if this right is cancelled and the State would have to bear the cost of such compensation. As a result, Mercosur countries are opposed to any provisions that go beyond WTO TRIPS obligations.

Olive Oil

Olive oil is one of the main agricultural products of the EU. Actually, this block is the leading world producer, accounting for 80% of the world's olive oil production and consuming 70% of it. Production of olive oil uses around 4% of the EU utilisable areas and approximately one third of the EU farmers are involved in the production of olive oil³².

In 2002, the EU exported 34 million euros of olive oil to Mercosur countries, which represent only 6% of the total extra-EU exports for this product. However, the EU is already positioned as Mercosur's main olive oil supplier, representing 79% of total Mercosur imports.

Despite the mentioned importance of olive oil for the EU-Mercosur bi-regional trade flows, few import restrictions to olive oil tariff lines are found in Mercosur. A 10% *ad valorem* common external tariff is charged on imports made by Mercosur members. So far, the block has not allocated olive oil in the established categories for tariff reduction, which shows that an instant liberalization is not probable.

On the other hand, the possibility of trading-off accession for European olive oil exports with accession for other Mercosur's agricultural export products becomes a difficult way to conduct negotiations, since the level of reduction on import restrictions would not be proportional for both parties. However, given the importance of this product for the EU agricultural exports, the allocation of the EU olive oil in a feasible tariff reduction category may become an important point on the overall discussions on agriculture.

³² European Commission. DG Agriculture.

Malt

The EU malt industry is currently expanding in the direction of new markets. The increase of beer consumption in the CEEC has motivated the sector to explore new markets. Currently, malt is one of EU's most competitive export product imported by Mercosur. Due to the growing demand of Brazilian beer industries, the total amount of malt exported to Mercosur represents 11% of total EU malt exports. In 2002, Mercosur imported 215,700 tons of malt from the 4,6 million tons of malt produced in the EU³³.

Mercosur applies a common external tariff of 14% *ad-valorem* on imported malt. This block also allocated this product on list "D", which implies a period of 10 years for tariff reduction, according to Mercosur's liberalization schedule proposal.

However, efforts to liberalize malt trade between the EU and Mercosur are quite timid from the point of view of EU offensive interests. Since Argentina is an important cereals exporter, the EU stands reticent to the full liberalization of malt flows, despite the fact that this product is one of the few examples of a positive trade balance for the EU in their trade relations with Mercosur. From this perspective, Mercosur's position may progress in the direction of a more liberalize-oriented proposal than EU's.

Furthermore, despite EU interests in the Mercosur malt market, it is possible to find very conservative positions among EU members concerning this product liberalization. France, for instance, clearly pushes to the exclusion of malt – as well as other cereals – from the current negotiations.

³³ Source: European Commission.

III. Scenarios and Conclusions

Considering the radical stances defended by Brazil and France – stances that have been exposed in this paper – and the discussions that have taken place during the last five years – which could be called a “*dialogue des sourds*” – we realize that no political progress has been made during this period. As a result, it becomes very difficult to figure out a probable scenario for the conclusion of these negotiations since there are almost no point of consensus between the French and the Brazilian positions in agriculture and therefore no balanced and realistic options. In fact, the most pessimistic scenario for Brazil is still too optimistic for France and vice-versa. However, the stances presented here are extreme positions. A feasible scenario for the conclusion of a bi-regional agreement that could be acceptable for the two blocs – and not for individual members – would stand between these two positions.

The three scenarios that we present below fit in the broad space standing between the two most radical positions expressed in this negotiation and the three of them are therefore realistic and plausible. Because the purpose of any FTA is to increase trade flows among its members, the qualification of our scenarios – optimistic, pessimistic and feasible– is directly related to the capacity of the agreement to be signed to create more or less trade. Thus, our optimistic scenario relates to an agreement that would foster substantial trade creation. To the contrary, our pessimistic scenario refers to an agreement that would not promote significant trade creation in agriculture. Our medium-range scenario is qualified as “feasible” because it is, in our opinion, the most-likely scenario. The trade creation capacity of an agreement based on this scenario would be moderate but tangible, reflecting the good will of the partners but also the genuine constraints imposed by their current domestic policies.

1. OPTIMISTIC SCENARIO

An optimistic liberalization scenario for EU-Mercosur negotiations would represent positive prospects for inter-regional trade as well as considerable changes in the EU domestic market.

In this scenario both parties should agree with a substantial and horizontal liberalization among the most important agricultural products of the EU and Mercosur, thus enhancing inter-regional trade flows through preferential access for products exported by both regions. This process could take place gradually but should include the following changes:

- f) Substantial reduction of over-quota tariffs allowing products, such as cereals, meats, sugar and dairy to enter in the EU market.
- g) If over-quota tariffs were not substantially reduced, a considerable amount of tariff rate quotas should be allocated to Mercosur countries exclusively with preferential access.
- h) Special Safeguard measures (SSG) should be suspended.

- i) Revision of quotas administration method should take place with the objective of improving the use of available quotas and increase competition among importers.
- j) The establishment of an agreement on geographical indications for wines and spirits.

2. PESSIMISTIC SCENARIO

A pessimistic scenario for agricultural products would maintain the *status quo* of the EU domestic market protection in the most sensitive products. This scenario would, however, establish a preferential access intra-quota. This scenario would include:

- e) Expansion of preferential access for some strategic products (i.e meats and dairy) through the creation of special quotas of [X] tons for the more demanding sectors, which would not improve general access for most products. Access conceded through quotas would be limited compared to Mercosur export potential for agricultural products.
- f) No reductions on over-quota high tariff rates.
- g) No suspension of special safeguard measures.
- h) No reform of quotas administration methods.

3. FEASIBLE SCENARIO

A feasible scenario – and the most likely – would be more complex, involving a combination of the different needs for each sensitive sector. Some problems – such as TRQs and TRQs administration – which are horizontal to most sensitive sectors – would receive special attention in the negotiations, thus implying reforms and new access in this area. New access, for some products, could take place through a two-step approach. According to this modality Mercosur goods will be granted some preferential and limited access to the EU market through the EU-Mercosur FTA. Then, Mercosur will receive an [X] percentage of the global volume that the EU will offer to third countries at the WTO. On the other hand, some particular sectorial demands would also shape the results of EU-Mercosur FTA.

The results of negotiations will, however, depend on the level of ambition of the trade-off with other areas under negotiation (non-agricultural market access, services, government procurement, etc.). If the trade-off offered is ambitious, expressive quotas and tariff preferences may be offered to Mercosur exports. On the contrary, in the case that trade-off offers are not significant, only small preferences on quotas and tariffs could be conceded. However, as regards trade-offs, it is important to underline that the acceptance of Mercosur to remove export subsidies and domestic support from the list of issues to be negotiated bilaterally is per-se a significant concession that should be taken into consideration in the global

trade-off. In addition, to compensate the absence of measures to eliminate export subsidies, the EU would have to accept the creation of intra-bloc safeguards that would be able to neutralize the impact of export subsidies granted by the EU to products exported to Mercosur, especially in the case of dairy exports.

In addition, through the two step approach a better access to Mercosur exports into the EU will depend on the level of ambition of third countries which are also market access demanders. Therefore the two step approach may be interpreted as a strategy to reduce Mercosur's ambition concerning market access in the Doha Round, which seems to be not acceptable from the point of view of Mercosur's interests.

Bovine and poultry meat

- a) Reduction of [X]% on over-quota tariffs for high quality beef (Hilton) and chicken cuts, allowing Mercosur to improve its participation in supplying EU's demand.
- b) Creation of an exclusive quota with preferential customs duties, which should be offered exclusively to Mercosur countries.
- c) Reforms of quota administration methods which is currently distributed according to the historical performance of importers. Historical allocation method is applied on bovine meat. Besides, a past trading performance requirement is applied on both bovine and poultry meat.

Pork meat

Probable scenario for liberalization of pork meat trade would be the improvement of SPS rules between the two blocks and the definition of preferential quotas. The clarification of SPS rules and the creation of preferential TRQs would be already an interesting result for the sector.

Sugar and ethanol

Substantial liberalization of sugar trade seems improbable in the EU-Mercosur negotiations since it is a very sensitive sector not only for the EU, but also for its former colonies connected by preferential trade schemes (i.e. ACP and EBA agreements). However, the EU could grant a tiny quota to Mercosur to prove its good will to the international trading community.

Ethanol fuel tariff rates reduction or the creation of a preferential TRQ is a good possibility for a trade-off. Since it is not so explored by the EU and very important for Mercosur, the improvement of ethanol access into the EU market could be part of a probable scenario.

Orange Juice

Since orange juice is not a polemic question in this negotiation, probable scenario would be a better tariff elimination classification, which is currently established in on list "D", meaning that full liberalization would take place only 10 years after negotiations.

Cereals

Even though cereals are very sensitive products for the EU, a probable scenario should consider that cereals include key products for both parties. The concession of preferential quotas for Mercosur exports, and tariff reduction will probably ensure market access in the scope of a bi-regional agreement.

Wines and spirits

A probable result for this sector would allow preferential tariffs for imports of alcoholic beverages exported by the EU. However, these preferences will not reach important levels as this industry is still growing in Mercosur countries and oriented to domestic market. It is also possible that EU and Mercosur will reach an agreement on geographical indications for wines and spirits.

The FTA between the EU and Mercosur could also entail a built-in agenda. The purpose of such a modality is not to exclude the sensitive products from the current negotiations but rather to accept to review the treatment of some sensitive agriculture products periodically, after the completion of the Doha Round or following the EU domestic reform of sectors left out of the Fischler CAP reform such as sugar.

In any case, the path and the scope of the EU-Mercosur negotiations are also deeply influenced by external factors. Currently these factors are rather pessimistic: agricultural talks at the Doha round are deadlocked and the FTAA negotiations tend towards the conclusion of a "light" agreement or a deadlock. These issues provide no incentive for the conclusion of an ambitious EU-Mercosur FTA. However, these circumstances could change in the next months. A substantial proposal by the EU and Mercosur could have a positive influence on other international trade negotiations and could give an impulse to regain momentum at the multilateral and regional level.

April 19 2004

Abbreviations and Acronyms

ACP	Africa, Caribbean and Pacific countries (71 members)
AVE	<i>Ad Valorem</i> Equivalent
BNC	Bi-regional Negotiations Committee
BSE	Bovine Spongiform Encephalopathy
CAP	Common Agricultural Policy
CEEC	Central and Eastern European Countries
EBA	Everything But Arms Initiative
EU	European Union
FAPRI	Food and Agricultural Policy Research Institute
FTA	Free Trade Area
FTAA	Free Trade Area of the Americas
GATT	General Agreement on Tariffs and Trade
GI	Geographical Indication
LDC	Least Developed Countries
MERCOSUR	Common Market of the Southern Cone
MFN	Most-Favored-Nation status
OFIVAL	Office National Interprofessionnel des Viandes, de l'Élevage et de l'Aviculture
PTA	Preferential Trade Agreement
SPS	Agreement on Sanitary and Phytosanitary Measures
SSG	Special Safeguard Measures
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TRQ	Tariff Rate Quota
URAA	Uruguay Round Agreement on Agriculture
US	United States

USDA United States Department of Agriculture

WTO World Trade Organization

Bibliography

- Abbott, P., 2001. *Tariff Rate Quotas: Failed Market Access Instruments?* Paper read to the 77th EAAE Seminar/NJF Seminar No. 325, August 17-18, Helsinki.
- AMAD, Agricultural Market Access Database. Available on-line at <http://www.amad.org/>.
- Bureau, J.-C., and Tangermann, S., 1999. *Tariff Rate Quotas in the EU*. Agriculture and Resource Economics Review, 29.
- Carfantan, J.-C., 2002, *La Mondialisation déloyale, pour un nouvel ordre agricole et alimentaire*, éditions Fayard, Paris.
- Chatellier, V., Guyomard, H., and LeBris, K. *Production bovine: entre économie de marché et politique de territoire*. Déméter 2004. Armand Colin. Paris, 2003.
- Directorate-General for Agriculture. *The olive oil sector in the EU*. European Commission, 2003.
- European Commission (1999), *CAP reform – A policy for the future*, (<http://europa.eu.int/comm/dg06/publi/fact/policy/en.pdf>). (Accessed November 2001).
- European Commission (2000), *EU Trade Concession to Least Developed Countries, Everything But Arms Proposal, Possible Impacts on the Agricultural Sector*, (http://europa.eu.int/comm/trade/pdf/eba_ins.pdf). (Accessed February 2004).
- European Commission (2001), *Agenda 2000*, (<http://www.europa.eu.int/scadplus/leg/en/s60000.htm>). (Accessed February 2001).
- European Commission (2002). *Analysis of the Impact on Agricultural markets and Incomes of EU Enlargement to the CEECs*. Directorate General for Agriculture, March.
- European Commission (2003). *Regulation (EC) 1789/2003 of September 11th 2003*.
- FAPRI (2003). *FAPRI Analysis of the Commission's Mid-Term Review Proposals*. Published in "Mid Term Review of the Common Agricultural Policy. Impact Analysis", European Commission, Directorate-General for Agriculture.
- FAPRI-Ireland (2003). *An Analysis of the Effects of Decoupling Direct Payments from Production in the Beef, Sheep and Cereal Sectors*. Special report prepared fro the Department of Agriculture and Food. FAPRI-Ireland Partnership.
- Gallezot, Jacques. *Real access to the EU's agriculture market*. INRA. Paris, 2003.
- Jank, M. (Coord.). *A reforma da Política Agrícola Comum da União Européia*. Institute for International Trade Negotiations (ICONE), DT 001/2003. São Paulo, 2003.

- Kazlauskiene, N. and W. H. Meyers. 2001. "CEEC Interests and Options in the WTO 2000 Negotiations". Chapter 6 in *Agricultural Trade Liberalization in a New Trade Round: Perspectives of Developing Countries and Transition Economies*, ed. M. Ingco and L. A. Winters. World Bank Discussion Paper No. 418. Washington, D.C. The World Bank.
- Matthews, A. and Laroche Duprazi, C., 2001, *Agricultural tariff rate quotas as a development instrument*, Economie Internationale 87, CEPII, Paris.
- Ofival (1991-2003). *Le marché des produits carnés et avicoles (1990-2003)*. Rapports annuels de l'OFIVAL, Paris.
- Ofival. *Les accords du GATT dans les secteurs des viandes et des oeufs : le bilan de l'Union Européenne*. Paris, 2003.
- Working group from the International Agricultural Trade Research Consortium (IATRC). *Issues in reforming tariff-rate import quotas in the Agreement on Agriculture in the WTO*. IATRC, 2000.
- WTO (2000) *Trade Policy Review: European Communities*, 2 volumes, Geneva, World Trade Organization.
- WTO (2000), *Tariff Quota Administration Methods and Tariff Quota Fill*, G/AG/NG/S8. (<http://www.wto.org/WTO/ddf/ep/public.htm>). (Accessed December 2000).
- WTO (2001), *UR: Market access for agricultural goods*, (http://www.wto.org/english/thewto_e/eol/e/wto01/wto1_45.htm). (Accessed April 2001).
- WTO (2003). Notification G/AG/N/EEC/42 from the European Communities for marketing year 2001/2002.
- WTO (2003). Notification G/AG/N/EEC/45 from the European Communities for the calendar year 2002.