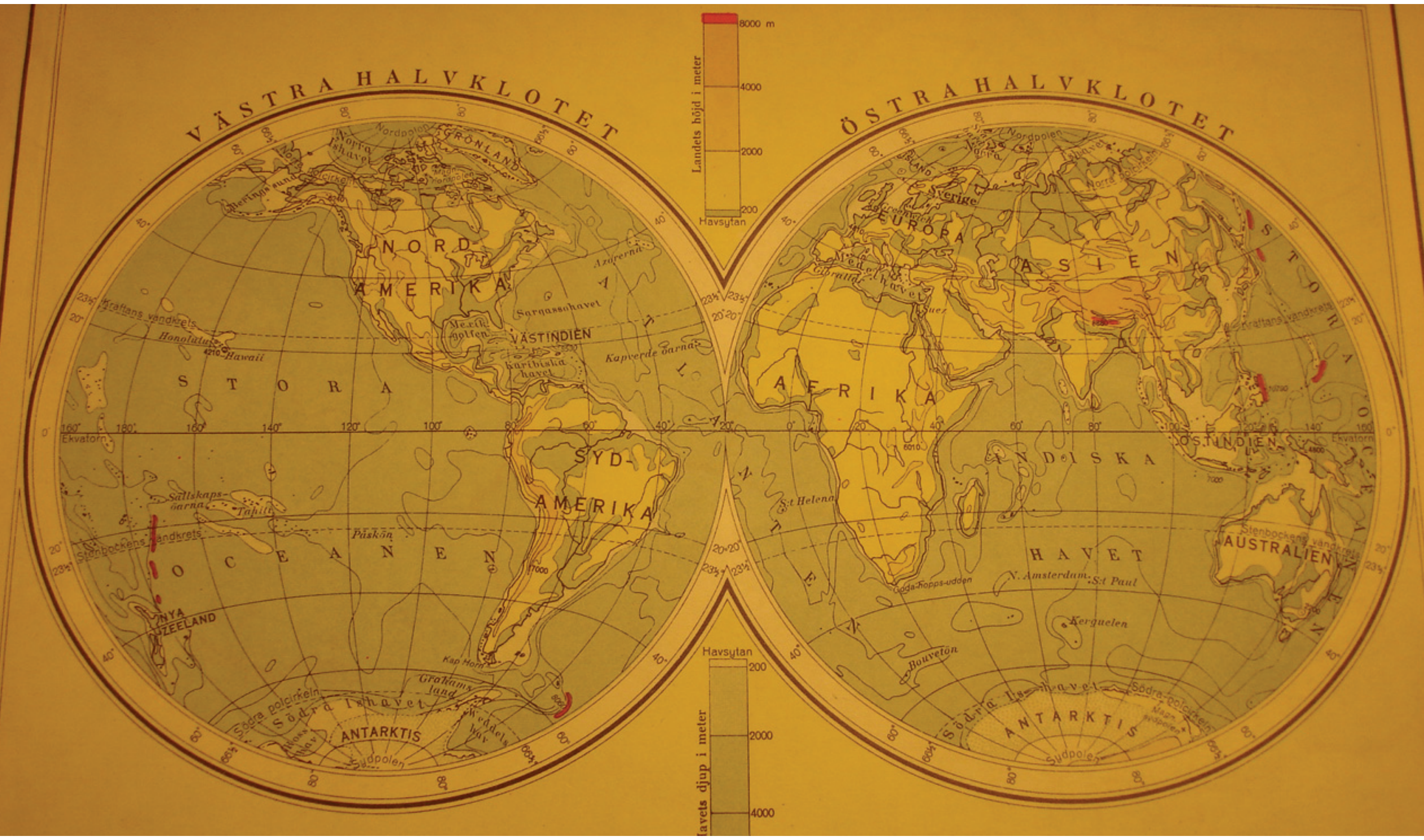
A Short Version

# New bilateral trade agreements

## – New opportunities for the agrofood industry




- The new bilateral agreements are expected to lead to lower tariffs, but also to more transparent technical trading rules. Correctly drawn up, the agreements may make it easier for the EU's agrofood industry to expand into new markets.
- The agreements may also lead to increased import competition. Many of the EU's highly processed products do, however, have excellent preconditions for asserting themselves well against the competition.
- The EU will probably not lower its tariffs very much on those input goods that are today considerably more expensive in the EU than outside it (for example beef, sugar and dairy products). If this is the case, it would put the EU agrofood industry at a disadvantage.

A Short Version of Report 2009:16

# Contents

# Why does the EU want more bilateral agreements?

The EU has had bilateral trade agreements for a long time with a number of major trading partners in countries close to us. On Sweden's part the agreement with Norway is particularly important. It is with our part of the world that most of our trade is conducted. During the last 10-year period not quite 70% of all trade in agricultural products has been carried out with countries which today are members of the EU 27.

The EU regards trade agreements as a means of expanding the union's competitiveness and in this way boosting growth and employment. It is a question of stimulating trade in general, but also of ensuring that EU companies are not given less advantageous terms than their competitors in important markets. The number of trade agreements in the world has increased rapidly during the 1990s and 2000s, and according to the World Bank (2005) more than a third of world trade takes place between countries that have some form of regional trade agreement with each other. The EU and Sweden still regard the World Trade Organisation WTO as the best route to more free trade. New bilateral agreements will build on WTO agreements and other international regulations, but will go further and faster as regards promoting openness and integration.

The new agreements are to be more far-reaching and cover more products than those agreements already in existence, and the parties are to liberalise trade as much as possible. The intention is also to abolish quantitative import restrictions as well as all forms of restrictions on exports (for example export tariffs and dues). The free trade agreements should also cover different forms of technical barriers to trade. It might, for example, be a question of the parties adapting certain technical regulations to each other so that trade will flow more easily. What is more, the rules of origin should be modernised.[1]

Agricultural products and food will be covered by the agreements. It is, however, unlikely that all tariffs will be removed on these products.

## Which countries is the EU negotiating with?

In the autumn of 2009 negotiations are being conducted between the EU and no less than 42 countries on new trade agreements. Not all of the negotiations are, however, being conducted with individual countries, but 31 of the 42 countries form part of five regions with which the EU is negotiating. The majority of those countries the EU is negotiating with are growth economies participating increasingly in world trade.

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[1] Further examples are the regulations on intellectual property, competition and good forms of government in the fields of finance, taxation and law.

Some of the countries with which the EU is currently negotiating free trade agreements are Canada, Korea, the Ukraine and India (see Figure 1).

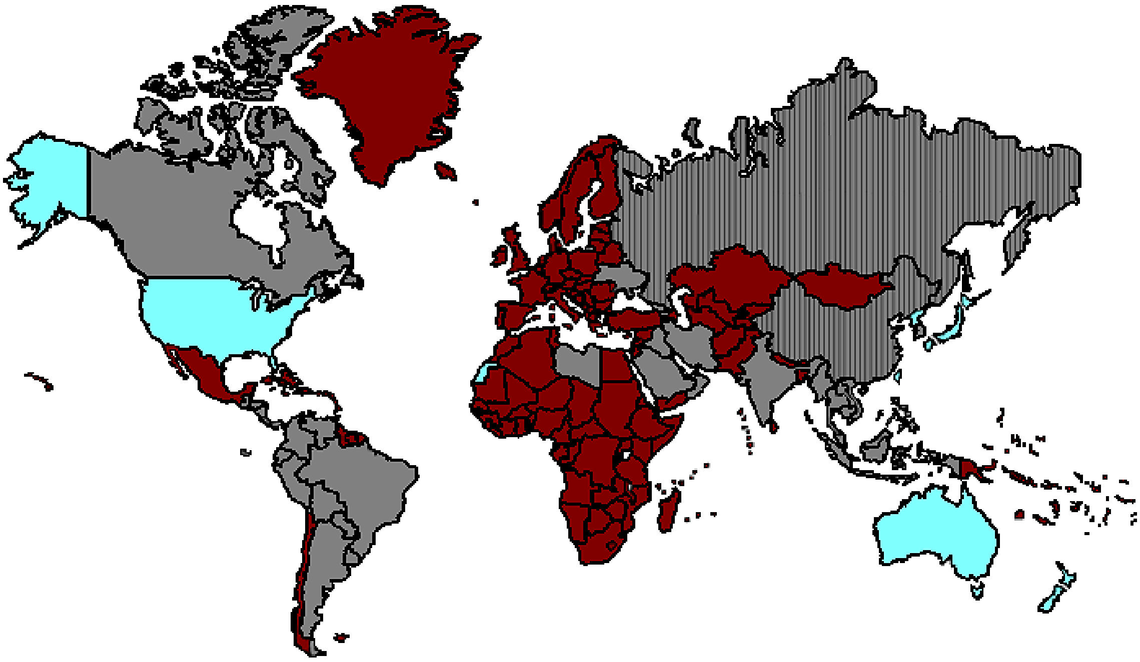

**Figure 1 EU trade agreements – now and in the future**

Note: Countries with which the EU is negotiating (e.g. Canada) are marked in grey. China and Russia are, however, marked with hatching, as the negotiations do not apply to tariff reductions at this stage. EU27 and those countries with which the EU today has bilateral agreements or developing country arrangements are marked in wine red. Those countries with which the EU does not have any bilateral agreements or developing country arrangements (e.g. the USA) are shown in turquoise on the map.

Source: Own adaptation, Swedish Board of Agriculture

As is clear from Figure 1, the EU already has trading agreements with a large part of the world, and if the current negotiations go without a hitch there will not be many countries left with which we do not have bilateral agreement. Some important markets are amongst these, however, primarily the USA, Japan and Australia. China is shown as hatched on the map, as EU negotiations with the Chinese do not at this stage apply to tariff reductions.

## Increased trade and export opportunities

Global trade in processed foods has increased relatively sharply over the past decade, and highly processed products comprise an increasing part of this trade. In recent times trade has, admittedly, been restrained by the economic crisis, but during the period 1995–2005 it grew in value by approximately 60%. This is a more substantial development than the development in unprocessed agricultural products.[2]

For this reason we have chosen to study what the new trade agreements might mean for the Swedish and EU agrofood industry. We have selected 15 processed products and 14 input goods that we will be studying in greater detail. The conclusions of the report apply only to the selected products. For other sectors the outcome may be different: tougher competition from imports and lower export potential may occur.

**Definition of processed products**

The agrofood industry produces a number of products with different degrees of processing, and we have chosen to use a broader definition (product classification) than the majority of other organisations and agencies. The reason is that we want to include products that are, admittedly, processed, but which have not been subjected to any extensive processing. This means that we, for example, count frozen, cuts of meat as a processed food. For a more detailed discussion of this the reader is referred to the Swedish Board of Agriculture report 2008:2, Processed food in the international arena.

# How is the agrofood industry affected?

## Good opportunities for increased exports

The EU is conducting negotiations with 42 countries, but the agreements are not all equally important for trade. Generally speaking, the size of trade grows with the size of the economies of the countries involved, and decreases with the distance between the countries. Cultural and linguistic similarities facilitate trade. Tariffs and technical barriers to trade are also significant when trade flows are being studied at a more detailed level.

Table 1 shows how we assess these factors as affecting EU exports to some of the countries with which the EU is currently negotiating. In the table the plus signs signify a positive effect on trade and the minus signs a negative effect. Tariffs always have a negative effect on trade, but high tariffs today mean that a bilateral agreement can lead to relatively major targeted tariff reductions in relation to the EU, which provides an advantage as compared with competitors in other countries

[2] The Swedish Board of Agriculture (2008:2)

**Table 1** **How are EU exports affected by new agreements with the selected countries?**

| | Size of the economy | Cultural similarities | Geography (distance) | Scope for tariff reductions (average tariff all agricultural products) |
|---|---|---|---|---|
| Mercosur | ++ | + | - | + |
| Colombia | + | + | - | ++ |
| Guatemala | + | + | - | + |
| India | ++ | + | - | +++ |
| Canada | ++ | + | - | ++ |
| China | +++ | - | - | ++ |
| Malaysia | + | | - | + |
| Russia | + | + | + | + |
| Thailand | + | - | - | ++ |
| Ukraine | + | - | + | ++ |
| Saudi Arabia | + | - | + | + |
| South Korea | ++ | - | - | ++ |

Note: Cutoff points for the size of the economy are > 1 200 billion US$ +++, > 500 US$ ++, corresponding interval for tariff reductions is 0-15 % +, 15-30 % ++, >30% +++. For cultural similarities a + is given if the country has both a common language and colonial past with an EU country.
Source: Comtrade

If we only take into account **economic size,** there should be a great potential for increased exports of agrofood industry products from the EU to China, Canada, India, South Korea, Brazil and Russia. Several of these countries have a rapidly expanding middle class, which is likely to demand more processed European products. Cultural differences can be a restraining factor in respect of some of the countries, primarily those in East Asia.

If we instead look at the **potential for tariff reduction**, we can see that the most protected markets today are India and Thailand. India's tariffs in particular are remarkably high, not least as regards alcoholic beverages. What is more, countries such as India, Russia and the Ukraine often apply different measures restraining trade, as well as complicated regulations which obstruct trade. If bilateral agreements are able to lead to improvements in this area, there should be a great potential for increased exports to these countries. The other countries do not demand particularly high tariffs for the products we have chosen to study. The EU companies will not, therefore, achieve any particular advantage compared with competitors in countries without agreements, but an advantage of 10% to 15% should not be disparaged.

As regards **the potential for providing the EU agrofood industry with cheaper input goods**, the agreements with Argentina, Canada and Brazil should be of the greatest interest. There are also, however, considerable opportunities for increasing imports from China. Nor should Russia and the Ukraine be ignored, as they are, among other things,major grain producers and are geographically close to the EU. There is, however, a considerable risk that the EU will not agree to any significant reduction of tariffs on input goods such as sugar and animal products.

All in all, the bilateral agreements which may be reached between the EU and India and Canada contain considerable potential for providing competitive advantages to the EU agrofood industry in these markets. This, of course, does not make the other agreements unimportant. China and Russia are very interesting markets, but in these cases the negotiations are not about direct tariff reductions.

Above all, the agreements can help increase the trade that already exists, as the fixed costs of entry have to a large extent already been paid. It is, however, more uncertain whether the new agreements will lead to significant changes in patterns of trade.

It is not clear when the new agreements can enter into force, since the negotiations will proceed at different paces. The situation in late September 2009 was, for instance, that final proposals had been presented in the Korea negotiations, while negotiations with Canada were just beginning, and the Mercosur negotiations had been on ice since 2004.

# Certain products will not be covered

The new bilateral agreements will presumably cover more agricultural products than many of the agreements the EU has today. It is, however, very likely that certain products will not be included, as the parties do not wish their products to have to face greater import competition.

To judge from how the EU has acted previously, new agreements will presumably contain few or no tariff reductions on sugar, dairy products and meat. These are products for which the EU has a comprehensive market regulation and for which the EU price often exceeds the levels applying in world markets.

The conditions for agricultural products also play a role in the agrofood industry. If the tariffs remain high on raw materials such as sugar and dairy products, then the EU's food processing companies will not get rid of the price disadvantage implied by high raw material costs. At the same time the agreement will lead to the EU reducing tariffs on processed foods, which will encourage greater competition in that market.

The agreements will also probably contain regulations on export dues and other measures which countries can resort to in order to reduce the export of raw materials. Regulations of this kind can help the EU's agrofood industry to achieve a more secure access to materials during periods of peak prices of the kind we saw during 2008.

## Effects on different groups of commodities

The EU's agrofood industry has excellent preconditions for coping with the increased competition, which may result from the EU lowering tariffs in the new agreements. Which products the consumers prefer result not merely from the price, but to a great extent from quality issues and more emotional factors relating to geographical origin, history and tradition. Aspects of this kind can be signalled, among other things, by means of successful brands which the consumers associate, for example, with a certain quality. The value of this should not be underestimated.

We do not, therefore, see any great risk in the new agreements leading to many producers of highly processed foods being outcompeted. Rather the agreements may lead to a wider selection for consumers, so that they have greater opportunities for choosing products according to their own preferences. There are, however, a number of agrofood industry products which the EU today is protecting with high tariffs (for example animal products and juices) and it is probable that import competition in these products may increase markedly when, or if, tariffs are lowered.

In the longer term it cannot be excluded that companies choose to locate their factories in countries or regions with major markets, as this, for example, implies lower transport costs and labour costs as well as a good access to cheaper materials. If new bilateral agreements in the longer term contribute to an increased emigration of companies, this would presumably have a negative effect on both the agrofood industry and employment in both Sweden and the EU, and run contrary to the aim of the agreements, which is to increase Europe's competitiveness and employment opportunities.

### *Bread, pastries and sugar confectionery*

This product category comprises sugar confectionery, chocolate, sweet biscuits and other biscuits and pastries. The EU applies tariffs of around 20% in this area, and many of the partner countries are comprised by the General System of Preferences (GSP) which means somewhat lower tariffs. If the EU abolished its tariffs, this would presumably lead to a greater import of the products in question and possibly a greater establishment of production abroad. The development would, however, scarcely be explosive. This, together with the great potential existing for intra-industry trade[3], means that the fears that the EU industry in this field may be outcompeted on the home market should not be exaggerated.

The EU is a net exporter of most of the products studied, which is particularly marked for sweet biscuits and chocolate. In exports to the countries studied, EU companies face tariffs at approximately the same level as those levied by the EU, and sometimes somewhat lower. India's tariffs are consistently the highest, approximately 30%. This means that new opportunities would be opened up to EU exports if these tariffs were to be removed. Simplified tariff administration would boost the effect further. Export

[3] Intra-industry trade implies that most trade occurs between countries exporting and importing similar products and with approximately the same technology and factor proportions.

increases would, however, presumably remain at a somewhat limited level with regard to the relatively modest tariff levels which often apply already.

The EU levies very high tariffs on almost all import goods of importance for bread, pastries and sugar confectionery. The fact that the majority of these products are excluded from the general preference system (GSP) indicates that the EU does not believe that domestic production would cope with international competition. It is, therefore, less likely that the EU will accept any major reduction in tariffs on these products (sugar and dairy products).

## *Alcoholic beverages*

Those alcoholic beverages we have studied are beer, wine, whisky and vodka. For certain of these products the EU is an important, and – for vodka – the leading exporter on the global market. The EU's exports of these products often greatly exceed what we import. There are, however, substantial imports, primarily of vodka from Russia and Ukraine, wine from Argentina and whisky from Canada. We do not consider that there is any major risk that the new agreements may lead to the EU industry being outcompeted, as EU tariffs are already very low (tariff exemption for beer, whisky and vodka and approximately 3% duty on wine).

Alcoholic beverages are, what is more, a product category in which many more factors than low tariffs and consumer prices decide the size of the volumes traded. Examples of such factors are quality, tradition and access to known brands. This does not, however, mean that the liberalisation which might follow the signing of a new bilateral agreement is without importance in this area. On the contrary, tariff levels for several of the countries studied are unusually high and liberalisation may, therefore, have fairly major consequences.

India applies very high tariff levels (100%-150%) for the product group. We believe for this reason that there is major potential for greater export to India, among other things bearing in mind the size of the Indian market and its growth potential, as well as the fact that a certain level of export already exists despite the high tariffs[4]. Thailand also levies high tariffs on alcoholic beverages (60%), and even in those cases where the tariffs are relatively low, reduced tariffs can produce fairly major effects if the markets where the reductions that are to occur are of a considerable size. Irrespective of whether the agreement is concluded or not, the greater prosperity of the partner countries, and the cultural and preferential development following in the wake of globalisation should also contribute to greater consumption of alcoholic beverages from the EU of high-quality and with a long tradition of production.

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[4] Certain countries, like Saudi Arabia, apply import bans on alcoholic beverages for ethical or religious reasons. In the Indian states of Gujarat (approximately 60 million inhabitants), Mizoram (approximately 1 million inhabitants) and Manipur (approximately 2 million inhabitants) there are also official alcohol bans, but the total Indian market is considerably larger, amounting to more than 1 billion consumers.

Increasing the EU's exports of alcoholic beverages to relatively poor developing countries might be regarded as controversial from an ethical standpoint. In the study a trade assessment is given, however, and no ethical evaluation has been carried out.

The most important input goods in the area are grain, grape juice[5] and sugar. These are products for which the EU does not like to provide tariff suspensions, and it is not very likely that the new agreement will change this attitude. On the other hand, the EU's grain prices do not always exceed world market levels, so the problem should not be exaggerated. It is, however, likely that the EU chooses to prioritise primary production over the processing industry. For certain niche products where tradition and authenticity are important characteristics the use of domestic input goods may, however, be preferable even if they are more expensive. One example is Absolut Vodka, where the fact that it is manufactured from Swedish grain (in this case wheat) is an important ingredient in marketing.

### *Processed animal products*

Those processed animal products we have studied are frozen cuts of pork and chicken. The EU usually regards these products as very sensitive to import competition, and it is for this reason not particularly likely that the agreements will lead to the complete removal of tariffs. We have, nevertheless, chosen to analyse what might be gained by a more comprehensive liberalisation. EU tariffs are initially around 50% for frozen chicken and 30% for frozen pork.

The trade in animal products is greatly affected by rules on hygiene and contagious diseases. The EU and Sweden have a good status in this regard and should, therefore, have good preconditions for exporting to all markets. To get a new country to accept animal products from different EU countries may, however, be a very long and complicated process. If the tariffs are lowered, it might be tempting to many countries to put a brake on imports with the aid of different technical obstacles instead. If tariffs are lowered, it is likely that existing exports increase rather than that new markets are opened up, at least in the short term.

Nor can EU companies rely on the agreements rapidly leading to new import opportunities. Even if the EU were to lower its tariffs, all the meat still has to come from approved countries and approved plants. Many of the countries with which the EU is currently concluding agreements do not have that status.

The product category of processed animal products is not as diversified as other categories we discuss here. There are, admittedly, differences in rearing methods and cuts of meat, but the variation is not by any means as great as, for example, for wine and sugar confectionery. This means that the there are fewer preconditions for intra-industry trade. An increased import into the EU market in the wake of a reduction in EU tariffs

[5] It is, however, (according to Council Regulation (EEC) No. 479/2008 article 27.3) not permitted to import grape juice into the EU from a third country for the production of wine or as an additive to wine.

would, therefore, hit the EU agrofood industry hard in this area. However, the global demand for processed animal products is expected to grow in pace with larger population groups in the developing countries being able to afford to consume them. This presupposes, however, that levels of costs in the various exporting countries do not differ by too much.

The EU is a major net exporter of frozen pork, but a net importer of frozen chicken. This applies also to the trade with those countries studied in detail here. The greatest exporter by far of frozen chicken to the EU is Brazil, but imports from, for example, Thailand are also predicted to grow in importance in the next few years. In its turn the EU exports frozen chicken primarily to Russia, Malaysia and the Ukraine. In the pork field the largest importing countries are Russia and South Korea, but the degree of Russian self-sufficiency is expected to increase. The EU's imports of pork from the countries studied is very small.

In four of the countries studied, to be precise in India, Russia, South Korea and Thailand, tariffs on pork are set at around 30%, that is to say at the same level as applies in the EU. For other countries the tariffs are set at lower levels. The OECD (2009) assesses that the import needs of India will increase over the next few years. It is probable that a liberalisation would have a positive effect on the EU's exports to these countries, and perhaps primarily to India. Brazil and China will, however, in time with great probability become increasingly important competitors to the EU on the international stage.

In the chicken area also the EU's tariff level is high (approximately 50%) in comparison with those levels applying in most of the countries studied[6]. India's very high tariff may cause it to appear that an agreement might be able to open up a new and important market, but there are three reasons to doubt this. The first is that it is not certain that poultry meat will be covered by the agreement. The second is that, for some years now, India has prohibited certain imports of pork and poultry from, among others, the EU, referring to the risk of bird flu. Thirdly the OECD (2009) assesses that India's import needs will decline in the future. On the global stage primarily Brazil and Thailand are expected to substantially increase their exports of frozen chicken in the future, which will presumably also affect the EU's chicken industry.

For chicken it is the case that many major importing countries, such as for example Russia, China, South Korea, Canada and Saudi Arabia, derive very small proportions of their total imports from the EU. It is difficult to say whether a tariff suspension would be sufficient to cause these countries to go over in part to EU-produced meat.

The EU levies high tariffs on carcasses of pigs and poultry which can be used as input goods in the production of, for example, deep frozen pies, pizzas and piroshki. It is not likely that the new agreements will alter the tariff levels greatly for these products. To the extent imports already exist one would imagine that the agreements will contain duty-free quotas based on existing trade. If more extensive liberalisation were to be

[6] The exception is India, whose tariff is at 100%.

implemented and –contagious disease regulations do not put a spoke in the wheel, it is however, possible that the cost of imported goods could be forced down in favour of the EU's agrofood industry. Frozen cuts of meat are not a particularly highly processed product, and it is uncertain whether the imports of carcasses and half-carcasses as import goods to the EU's processing industry in the area may be expected to increase in association with a liberalisation. High transport costs may instead be thought to make it more profitable to joint the animals in situ in their countries of origin and then export them.

## *Other products*

The processed agricultural products which come in the category "Other products" comprise cheese, frozen berries, juices, food preparations as well as soft drinks and flavoured water. The products differ considerably from each other, so for this reason we will comment on them separately below. As regards GSP, frozen berries, juices, soft drinks and flavoured water are included completely in the system whilst food preparations are only included in part and cheese is entirely excluded. On cheeses above all, significant WTO import quotas are applied with different degrees of tariff reduction.

The EU tariff level on **cheese** is high (just under 50%) and a liberalisation would increase imports to the EU. It is, however, not clear that an import of this kind always competes directly with the sale of proprietary cheeses (i.e. those with geographical indication and traditional speciality) from the EU.

Countries such as India and South Korea have high tariffs on cheese, and if the agreements lead to major tariff reductions, one factor holding back exports to these countries will disappear. Curd as an input good may, to an increasing extent, be imported from countries such as Argentina, Brazil and the Ukraine, as a result of greater production there and of lower tariffs as a result of bilateral agreements. The EU's imports today comprise only a small proportion of the total exports of these countries. If it were to become profitable to import raw materials for further processing, there is presumably scope for these imports to increase.

The EU's tariff on **frozen berries** is modest (approximately 20%), and nor is the category regarded as equally sensitive, as it is covered by the GSP system. The countries studied also levy relatively low tariffs, with the exception of India, China and South Korea, who have tariff levels at 30%. The EU should be able to increase its exports to these countries if and when the new agreements come into force. China and Canada especially are major importers of frozen berries, but derive rather small proportions of their imports from the EU, which indicates a potential for greater trade. Canada, Russia and the Ukraine are significant exporters to the EU, and the climatic and natural similarities mean that it is possible that the export is in large part made up of the same kinds of berries which Sweden primarily trades in. Liberalisation may increase competition from these countries, but may also imply a guaranteed supply of cheap import goods to the Swedish berry processing industry, which has already built up resources in the area. The EU's imports of berries from Canada, Russia and the Ukraine are low when seen from an international perspective.

The EU’s tariffs on **juices** is rather high (40%), but the product category is nevertheless covered by the GSP system. Liberalisation would lead to greater imports, even if some of these probably would be juices or cordials from products not produced within the EU. Among the partner countries the high tariffs in India and South Korea stand out. If trade is liberalised, the EU will probably be able to increase its exports to these countries. Canada, Saudi Arabia and South Korea are major importers on the international stage, whose imports of juices from the EU do not in any individual case comprised more than 10% of their total juice imports. New markets can also be opened up for rather exotic “niche juices” or “niche cordials” based on traditional Swedish raw materials. The import of fresh berries and fruits as import goods can be limited by relatively low unit values, which might make transporting them unprofitable. The tariffs on these import goods are today already low, Canada, for example, may export more fruit and berries to the EU as a result of a liberalisation. The Swedish berry processing industry would then be able to exploits this in order to press down raw material costs.

The product category **food preparations** is a very heterogeneous group, for which the EU’s fixed tariff is set at a rather low level (15%), and it is not likely that a liberalisation would lead to a major increase in imports. Among the partner countries tariffs are very high for India and South Korea, which is why a liberalisation may be expected to lead to considerable increases in the exports to these countries. Canada is, what is more, a major importer globally speaking in this area, but derives only around 9% of its imports from the EU, which figure it should be possible to improve. The product category’s very diverse character means that a great variety of import goods can be used in production. Generally speaking a greater supply of cheap input goods might be possible in case of liberalisation.

The EU levies rather low tariffs on **soft drinks and flavoured water** (under 10%). It is, therefore, not likely that imports of the product category will increase a great deal in connection with the conclusion of new agreements. What is more, factors such as brand are assessed as having major significance in this area. Among the countries selected the highest tariffs on soft drinks and flavoured water are levied in India (30%), but also the Latin American countries, Malaysia and China have, in this regard, rather high tariffs (20%). It is probable that the exports from the EU to these countries may increase in connection with a liberalisation of trade, particularly bearing in mind the many strong brands which EU industry possesses in this field.

# Would you like to know more?

In the Swedish Board of Agriculture report 2009:16 – “New bilateral trading agreements – New opportunities for the agrofood industry” – a more detailed account is provided of the EU’s ongoing bilateral negotiations, including technical trade barriers as well as current trade. What is more, the suspensions of EU tariffs provided in the existing bilateral agreements are listed. The report may be ordered or downloaded as a pdf file from the Board of Agriculture website at <www.jordbruksverket.se>. The report is available in Swedish only.

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