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Policy Note ALECA

Regulatory approximation under ALECA: assessing the economic and social effects on the Tunisian agricultural sector

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The negotiations on a deep and comprehensive free trade area between Tunisia and the European Union (EU) – also known by its French acronym 'Projet d'accord de libre-échange complet et approfondi' (ALECA) – have been ongoing since 2015. Beyond the bilateral reduction of tariffs and quotas, the EU proposes regulatory alignment of Tunisian legislation to EU regulatory standards to foster trade and economic growth. However, taking into account the additional compliance costs for Tunisian producers and the public sector, our impact assessment concludes that ALECA has significant downside risks, as value-added in Tunisian agriculture might decline by -8.3 %. These effects need to be considered in the negotiations and in the broader context for sustainable agricultural development in Tunisia. **[1]**

A difficult context

Tunisia has gone through a political transition and has experienced significant social uncertainty and a difficult security situation since the Arab Spring in 2011. Due to slowing economic growth, rising current account deficits and strong currency devaluation, Tunisia has received substantial financial support from the IMF and the EU. Financial assistance has, however, been linked to conditionalities for institutional and political reforms, which also affect the agricultural sector, for instance through a new Law on Sanitary Safety introduced in 2019, that mirrors the EU institutional framework.

Agricultural, fishery and processed agricultural production are still highly relevant for the Tunisian economy, contributing 13.7% of GDP and around 15% of employment in 2019. Agricultural policies in Tunisia aim for a high level of self-sufficiency for the main commodities and affordable consumer prices for basic necessities on the one hand, and support of export products, such as olive oil on the other hand (Chebbi et al. 2019). Expenditures on producer and consumer subsidies and the high level of import protection have been severely criticised as inefficient, costly and welfare reducing (World Bank 2014). Also, agricultural trade liberalization was largely excluded from the existing Association Agreement with the EU, which entered into force in 1998.

Far-reaching liberalization through ALECA?

The liberalization of the Tunisian agricultural sector has been a key issue in the ALECA negotiations since the first formal round of negotiations in Tunis in 2015. The EU requests a far-reaching liberalisation of tariffs and tariff quotas for agricultural products, on which both partners still largely charge MFN tariffs. Given the higher level of tariff protection and the already existing preferences (in particular the quota regulations on olive oils), the greater absolute effort in dismantling tariffs in response to ALECA will fall on Tunisia. A 10-year transition period and a negative list approach for the exemption of sensitive products are supposed to account for such burdens.

Beyond the changes in tariffs and quotas, an EU principle for ALECA negotiations is that «Tunisia shall progressively approximate its sanitary and phytosanitary regulations to the EU acquis» (European Commission 2016: 2). Such demands for regulatory approximation are motivated by enhanced market access to the EU market, once Tunisian companies comply with EU regulations. The potential economic benefits for Tunisia in the long run should emerge through higher competitiveness and efficiency in the sector. However, such rationales have been put into question.

Scrutinizing the rationale for regulatory approximation

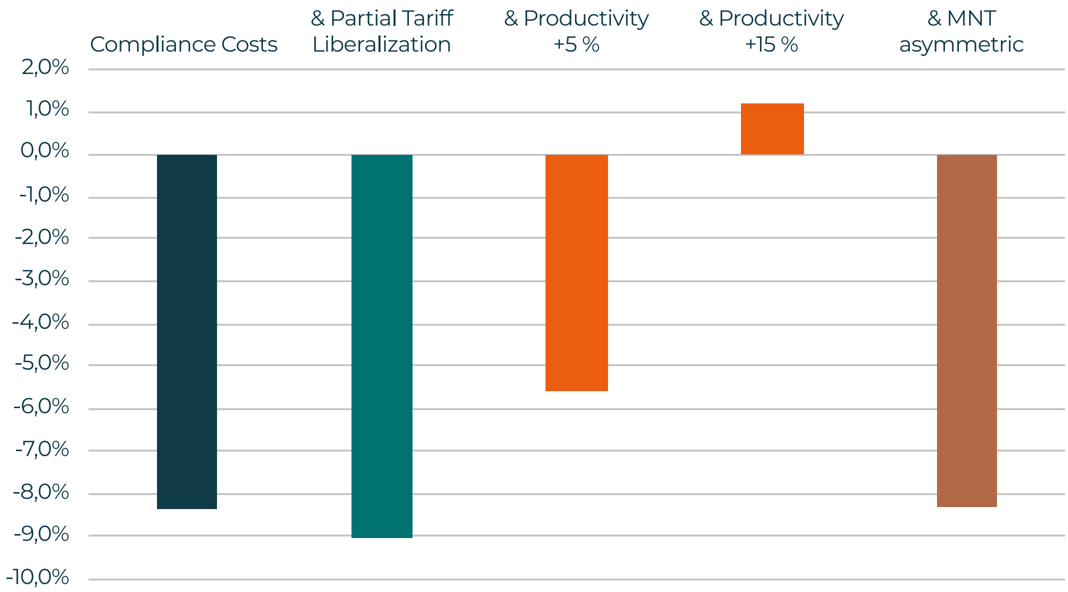
A critical review of the theoretical and empirical literature on non-tariff measures (NTMs) confirms that the full effects of the adjustments of regulatory frameworks and standards are not yet well understood (see for instance UNCTAD 2018). This is related to the nature of regulatory measures, which have multiple impact channels on public policy goals, welfare, value addition, as well as trade flows. A simplified conceptualisation of NTMs as representing costs to trade and foregone trade, respectively, excludes crucial beneficial effects of regulations, which are, for instance, related to correcting for market failures, the role of national preferences for the stability of regulatory frameworks, or the trade-enhancing effects of NTMs.

Moreover, one-sided regulatory approximation implies costs of compliance with public and private standards for companies. Previous examples of harmonisation to EU regulations in Central and Eastern European countries as part of their EU accession process as well as of regulatory alignment under EU Association agreements with Ukraine, Moldova and Georgia show that economic effects on value-added, trade, company structure and employment in the agri-food sectors of these countries have been highly mixed, despite substantial financial support by the EU. These outcomes have to do with the challenges that private companies face when complying with EU regulations and by the problems of public bodies to implement and enforce new regulations, which is, however, a prerequisite for enhanced market access.

Economic effects of regulatory compliance costs

Standard trade impact assessments treat regulatory adjustment as a reduction of trade costs, which generates benefits from lower costs and prices. The costs of complying with new standards are usually side-lined. Interviews with Tunisian exporters to the EU and other agricultural producers allow us to identify the necessary tasks and costs for employment, intermediate products and services associated with complying to EU requirements. On the basis of the survey, we are able to quantify these compliance costs and simulate the effects on agricultural and food sectors with the ÖFSE Global Trade model, a structuralist CGE-model. Total compliance costs related to the full harmonisation to EU regulations might cause a **decline of value-added in Tunisian agriculture by -8.3 %** (or -1.0 % of GDP for the whole economy). This is largely related to adjustments to **EU public regulations (value-added -6.5 %)** and partially to **private standards required by EU buyers (value-added -1.9 %)** (see Figure 1). Sectoral outcomes are most pronounced for those sectors primarily serving the domestic market, such as ‘meat’ or ‘dairy’, although more export-oriented sectors such as ‘vegetables & fruits’ are also affected.

Figure 1: Changes in value added in Tunisian Agriculture (different scenarios)



Source: CGE modelling calculations

No compensation through tariff and quota liberalization, strong productivity gains necessary

For a comprehensive picture of the multiple implications of ALECA on the agricultural sector in Tunisia, the effects of bilateral reductions in tariffs and quotas and potential changes in productivity and NTM trade costs are included in additional simulation scenarios. Bilateral tariff liberalisation magnifies the effects of compliance costs, even if tariff rates in Tunisia were only reduced partially, **with an overall effect on agricultural value added by -9.0 %**. A more balanced outcome for Tunisia depends essentially on the removal of the EU quota on Tunisian olive oils.[ii]Tariff liberalisation will also reduce public revenues and harm the **public balance (up to 0.59 percentage points relative to GDP)** and, thus, could exacerbate an already difficult fiscal situation. Positive effects from ALECA for Tunisian agriculture will depend on a strong increase in agricultural productivity and/ or a large and asymmetric reduction in NTM-related trade costs in order to compensate for the negative effects from regulatory approximation and tariff liberalisation.

Only with a **productivity increase of 15 %** above EU productivity changes, **agricultural value-added would rise by 1.2 %**, while **employment would decline by 7.9 %.** Also, NTM-related trade cost savings at the border from regulatory approximation are not sufficient to compensate for the adverse effects from compliance costs.

Productivity increases are, however, hard to achieve in the first place as the examples of harmonisation with EU regulations in Eastern European countries show. Moreover, productivity gains come along with reduced employment in agricultural sectors, which must be absorbed by other sectors of the Tunisian economy. What is more, any strong increase in agricultural production might be limited by the availability of water resources and the capital investment required for upgrading production systems, e.g. by introducing modern irrigation systems.

Institutional implementation challenges

Interviews with the relevant government bodies in Tunisia underline the regulatory and institutional challenges of regulatory approximation. Tunisia is already in a process of alignment towards EU regulations on some agricultural issues, also as a consequence of the conditionalities attached to EU macro-financial assistance. The on-going implementation of the new Tunisian Law on Sanitary Safety (LSS) shows the institutional challenges of such regulatory changes, for instance the shift of competences between ministries and towards new institutions, and underlines the capacities necessary to implement reforms. Further, the approximation process toward EU regulations raises issues with respect to export diversification strategies and ignores context-specific challenges for the Tunisian institutional system that are relevant for the sustainable future development of Tunisian agriculture.

Implications for the ALECA negotiations and agricultural policies

The promised economic benefits of enhanced access to the EU market through regulatory approximation are challenged, when considering the effects of regulatory compliance costs Tunisian producers have to cope with due to regulatory approximation with more stringent EU standards. The results of our assessment lead to several policy recommendations for Tunisia with respect to the ALECA negotiations and changes to the regulatory framework:

Assess implementation costs in a comprehensive and systematic manner : The complex effects of the ALECA agreement on Tunisian agriculture must be systematically assessed, with particular attention paid to the adjustment process and the related burdens for companies and the public sector. The promised benefits from regulatory approximation cannot be taken for granted. Compliance costs for Tunisian producers will be substantial, and capacity-building in the public sector will require institutional and financial support. Even though EU funding could form part of this support, it is unlikely to compensate for all costs incurred.

Insist on highly asymmetric market opening : In the negotiations on tariff and quota reductions, the Tunisian government should insist on highly asymmetric market opening. The potential benefits from EU quota removal and the protection for agricultural products are crucial for balanced outcomes. In particular, the removal of the EU quota on Tunisian olive oil will be absolutely crucial in determining the short-term effect of the agreement on Tunisian exports. While a removal would facilitate the export of bottled olive oils with higher value-added, the overall benefits must also be weighed against the already high level of tariff-free above-quota exports under EU inward processing arrangements.

Avoid regulatory alignment on a broad scale and focus on export-oriented products : Regulatory changes in the direction of EU standards should be restricted to those agricultural products with clear export potential to the EU, such as olive oil, and selected products in the fish and 'vegetables & fruits' sector. In sectors oriented towards domestic consumption, the case for regulatory alignment to EU standards is weak, involving very high compliance costs and a change in company structure with potentially high social costs. Any adjustment to regulatory frameworks must take into account multiple aspects, including production and employment in domestic agriculture, food security, consumer protection. Any SPS reform with alignment to EU or any others standards should assess potential impacts on export opportunities to other markets. A strict adjustment to EU regulations for the entire agricultural sector would put some of these basic policy goals at risk.

Focus on increasing value-added of agricultural exports: Given the limited availability of water and stringent ecological constraints, the scope for quantitative increases of agricultural exports in the respective sectors, i.e., 'vegetable oils' and 'vegetables & fruits', are highly circumscribed, and, in addition, require major investment in modern irrigation systems and other productivity-enhancing measures. Export potentials will, thus, have to concentrate on increasing value-added in production by focusing on high-quality products yielding higher prices and profits on the EU market. As the EU quota on Tunisian olive oil is a particular impediment to the export of bottled olive oil, this makes the elimination of the oil quota all the more urgent.

Assess downside risks for agricultural smallholders : The downside risks of regulatory approximation, in particular for smallholders, must be taken seriously, and an assessment based on detailed data by type of producers is advisable once such data are available. Compliance costs will be difficult to bear for small producers, who will, at the same time, also eventually face stronger import competition from the EU. Comprehensive agricultural policies and support tailored to the needs of small producers will be necessary for the sectors affected by regulatory alignment.

Strengthen institutional capacities of public regulators within a context-specific reform of SPS standards: The organisational and financial capacities and capabilities of public institutions to upgrade and meet the gaps related to the national SPS system in Tunisia should be strengthened. Regulatory reform must take into account the structural challenges and specific needs of Tunisian agriculture. In addition, public institutions should pay particular attention to supporting export companies in complying with the private standards demanded by EU buyers, as this represents an additional barrier for Tunisian producers seeking access to the EU market.

Define the role of trade liberalisation within a framework of sustainable agricultural development: The Tunisian negotiating position in the ALECA negotiations should be congruent to a strategic vision for the future of Tunisian agriculture, based upon a model of sustainable agriculture as set out by SDG 2 of the UN Sustainable Development Goals: “End hunger, achieve food security and improved nutrition and promote sustainable agriculture”. The trade-offs between agricultural trade liberalisation and the goals demanded by SDG 2 should be well understood.

Far-reaching liberalisation of agricultural trade will have substantial implications for the production structure and for policy goals such as self-sufficiency and food security. In particular, structural changes in agriculture triggered by regulatory adjustments, tariff liberalisation and potential productivity increases bear the risk of reduced employment. This will put pressure on other sectors of the Tunisian economy to absorb the surplus workforce and will increase rural-urban migration. Given the sensitive social and political situation in Tunisia, a circumspect approach to agricultural modernisation thus seems warranted.

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[i] This policy note builds on the results of a comprehensive study (Raza et al. 2022), conducted by the Austrian Foundation for Development Research (ÖFSE) and Observatoire Tunisien de l'Economie (OTE), and commissioned by Rosa Luxemburg Stiftung North Africa. The economic assessment is based on simulations with the ÖFSE Global Trade Model, a structuralist Computable General Equilibrium model. The qualitative analysis is based on text and data analysis, literature reviews and interviews and surveys in Tunisia.

[ii] The assessment of the tariff and quota liberalization is complicated by the EU tariff rate quota regulation on olive oil, the major agricultural export product of Tunisia. The calculation of ad-valorem equivalents of such quotas, needed for quantitative impact assessment, is notoriously difficult. Given the high level of duty-free trade flows of Tunisian olive oils, the tariff rate equivalent in Southern EU countries for vegetable oils from Tunisia estimated at 48.4 % by the widely-used GTAP database appears unrealistically high. In our simulations, we also show results for a tariff rate equivalent of 24.2 %, or 50% of the GTAP rate. See detailed discussion in Raza et al. (2022).