

SUSTAINABILITY IMPACT ASSESSMENT STUDY OF THE EURO-MEDITERRANEAN FREE TRADE AREA

SUSTAINABILITY IMPACTS OF THE EURO-MEDITERRANEAN FREE TRADE AREA

Executive Summary: Phase 2 of the SIA-EMFTA Project

PRELIMINARY CONSULTATION DRAFT

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Executive Summary

This report describes the results of the second phase of a project being undertaken for the European Commission, to assess the economic, social and environmental impacts of the evolving Euro-Mediterranean Free Trade Area (EMFTA). Phase One of the project developed the methodology to be used. This report presents the results of Phase Two, in which a broad overview sustainability impact assessment (SIA) has been carried out for the region as a whole. The results are intended to provide information for the negotiations and for the development of parallel policy measures, and to identify priorities for more detailed studies in the third and final phase of the project. The principal findings of the overview impact assessment are presented in this Executive Summary, together with recommendations for negotiators and policy-makers in the EU and Mediterranean Partner Countries (MPCs).

The SIA analyses the impacts of four components of a postulated EMFTA scenario, in comparison with a without EMFTA baseline scenario. These four components cover removal of tariff and non-tariff barriers for industrial products, agriculture, services and south-south trade liberalisation. Liberalisation of industrial products is as defined in the current Association Agreements between the EU and MPCs. For the other three components, the postulated scenario includes all the major issues covered by the ongoing negotiations. For industrial products, some of the impacts will already have occurred in those MPCs that have begun tariff reductions, and this is taken into account in the assessment.

For all four components of the EMFTA scenario, significant impacts will be specific to the conditions in individual countries, and will vary in particular according to the level of existing tariff and non-tariff barriers, and the proportion of EU trade in a country's total international trade. Impacts are also time dependent, with variations in both magnitude and direction between the short term, medium term and long term. These effects are taken into account.

The assessment initially gives worst case indications of potential impacts, assuming that no mitigating actions are taken. It then proceeds to assess potential policy measures to mitigate adverse impacts or enhance beneficial ones.

Principal findings

Impacts in the EU

The economic impacts for the EU are expected to be beneficial overall for all four components of the EMFTA scenario, but fairly small in terms of direct economic efficiency. The results suggest a net gain in consumer welfare of the order of 0.2% of GDP for industrial products, with little difference between the short and long term. For the other three components of the scenario the additional impact on welfare for the EU is close to zero.

Larger economic gains may occur in the longer term for services, and to some extent for industrial products, associated with investment effects. These cannot be forecast with certainty, as they will be strongly dependent on individual investment decisions and other aspects of economic and development policy in both the EU and MPCs.

Significant potential adverse social impacts arise in the EU for agricultural liberalisation. These are mainly restricted to local rural areas of southern European countries, where the types of crops grown are similar to those produced in MPCs. In some areas, the affected workers will include temporary migrants from MPCs, with a knock-on effect on social issues in MPCs. Both positive and negative

environmental impacts are expected. Impacts on water resources, agricultural pollution and biodiversity are generally beneficial, while those on the agricultural value and amenity value of rural environments may be adverse.

Impacts in MPCs

In terms of direct effects on consumer welfare, the economic impacts in MPCs are generally positive, although a small short term negative effect is possible in some countries. For industrial products, welfare is expected to rise by an average of about 0.8% of GDP, ranging from slightly less than zero in some countries, up to about 2% of GDP in others. For agriculture and services the additional welfare gain averages about 0.5% for each, with a small additional impact from south-south liberalisation.

Greater increases in welfare may occur in the long term, but these are strongly dependent on domestic reforms and investment decisions. In particular, there are large potential economic benefits from fuller regional integration, but to achieve them, other policy measures are needed in addition to south-south trade liberalisation.

The study identifies some social impacts that are beneficial in the short term as well as the long term, and others that may be significantly adverse unless effective mitigating action is taken. The potential impacts of greatest concern are:

- a significant rise in unemployment, particularly for liberalisation of EU-MPC trade in industrial products and agriculture, and to a lesser extent for services and south-south liberalisation;
- a fall in wage rates associated with increased unemployment;
- a significant loss in government revenues, with consequent social impacts through reduced expenditure on health, education and social support programmes;
- greater vulnerability of poor households to fluctuations in world market prices for basic foods;
- adverse effects on the status, living standards and health of rural women, associated with accelerated conversion from traditional to commercial agriculture.

Similarly, both positive and negative environmental impacts are expected. The main potential adverse impacts that have been identified are:

- significant local impacts on water resources, soil fertility and biodiversity in areas of high existing stress;
- higher environmental stress in cities, resulting from declining rural employment and accelerated rural-urban migration;
- higher air pollution and coastal water pollution from greater international transport;
- higher waste generation from greater use of packaging materials.

Many of these potential impacts would occur primarily in the short or medium term, although this may be as long as ten to fifteen years over the full period of adjustment. Unless effective action is taken in the short term, some impacts may continue into the long term.

Global environmental effects

The assessment indicates an overall adverse impact on climate change and global biodiversity, arising primarily through increased transport and greenhouse gas emissions, and pressures for increased agricultural production in biologically sensitive areas in MPCs. Both of these scale effects, which arise from increased trade and increased production, can in principle be countered by technology or regulatory effects. In itself, the EMFTA scenario that has been assessed does not include measures which will strengthen these positive effects sufficiently to counter the adverse ones. The study does however indicate an overall economic gain, part of which could be directed towards parallel actions to mitigate the expected impacts.

Impacts on the Millennium Development Goals

The SIA has implicitly evaluated the impacts of the postulated EMFTA scenario on the Millennium Development Goals (MDGs), through the core indicators that frame the SIA methodology. It shows that unless effective mitigating action is taken, there will be a small but significant adverse effect on Goals 1 (poverty), 2 (education) and 4 and 5 (health). Both positive and negative effects occur for Goal 7 (environment), while the impact on Goal 8 (global partnership) is positive. The potential adverse impacts arise primarily from a short term rise in unemployment and loss in tariff revenues, occurring mainly for liberalisation of industrial products, but with additional effects from the other components of the EMFTA scenario. Without effective mitigation, some of the short term effects may continue into the long term.

Recommendations for negotiators and policy-makers

The SIA study is not intended to make specific recommendations for the negotiating positions of the EU or MPCs. However, negotiators in all countries are urged to take account of the impacts discussed above, in developing their positions and throughout the ongoing negotiation process. In particular, they should note the potentially adverse effects on Millennium Development Goal 1 (extreme poverty and hunger), and the mixed effects on Millennium Development Goal 7 (environmental sustainability). Negotiators and policy makers are urged to satisfy themselves that measures such as those discussed below are being taken within the negotiations and alongside them, in sufficient degree to counter these potentially adverse effects.

More specific policy measures have been identified for actions which may be taken to mitigate adverse impacts and enhance beneficial ones. As well as trade-related measures that are subject to negotiation, these apply to domestic policy in the EU and MPCs, and to actions which may be taken by the EU in its development assistance programmes within the Barcelona process and in its contributions to international efforts to strengthen global governance.

Trade-related measures

Measures that may be taken within negotiated agreements include both the extent of liberalisation and the timing of implementation.

- For industrial goods, the phasing of liberalisation may be adjusted to take account of the evolving conditions in individual MPCs, particularly in respect of the level of unemployment and the implementation of tax reforms to compensate for lower tariff revenues.
- Similar flexibility in timing may be incorporated into agreements for agriculture, services and south-south liberalisation, and may be linked to the monitoring of actual conditions for key economic, social and environmental indicators.
- For agriculture, special arrangements may be identified for those products for which large production changes are anticipated in either southern EU countries or MPCs. Such arrangements may be optimised by a thorough evaluation of the alternative options. This may for example take the form of collaborative research into the interacting impacts in both the EU and MPCs, including participatory evaluation on both sides of the Mediterranean of the alternative lifestyles of affected groups, and a fuller evaluation of the environmental issues. The options to be considered would include continued protection for sensitive products, the removal of protection combined with programmes to support the multifunctional role of agriculture, phased transition from one to the other, and phased transition to full liberalisation. The timing of negotiations would need to be compatible with the availability of the research findings.
- For services, special arrangements may be identified for those services for which strong regulation and/or government subsidies may be needed in order to avoid potentially adverse impacts. This may for example apply to distribution services (with potentially significant adverse impacts on small traders), environmental services (related to the availability and cost of supply to poor communities) and financial services (related to lenders' sensitivity to local

cyclical pressures and gaps in the credit system). Such arrangements may for example include linking the timing of liberalisation to monitoring the implementation of the necessary regulatory reforms.

- Similar arrangements may be incorporated into south-south agreements.
- In negotiating these and other measures, negotiators are encouraged to note the specific effects discussed in the full SIA report, alongside the arguments presented by their counterparts in other countries.

Domestic policy in the EU

Adverse impacts within the EU occur primarily for agriculture.

- Develop social policy and environmental policy for affected areas of southern EU countries in line with the findings of detailed research on agricultural reform, for example as developed for CAP reforms, extended to cover the specific impacts of EU-MPC liberalisation..

Domestic policy in MPCs

For all four components of the EMFTA scenario, action needs to be taken by MPCs to avoid or minimise significant adverse social and environmental impacts, and to enable the potential benefits to be realised.

- Direct measures to help industrial companies increase their competitiveness against European companies (equivalent to Tunisia's *mise à niveau* programme). Measures may for example include assistance to both large scale producers and SMEs to access appropriate information and funding for modernisation, schemes to facilitate the development of internal supply chains, and initiatives to strengthen the responsiveness of education and training systems to changing private sector needs.
- Measures to facilitate the transition to commercial agriculture, fully integrated with parallel measures to support the livelihoods of subsistence farmers during the transition period. Facilitation measures such as land reforms, skills training and micro-credit schemes may be combined with initiatives to promote the development of rural industries and accelerate the creation of alternative sources of income in rural areas.
- Cooperative investment in regional transport and other infrastructure.
- The development of integrated regional industrial and agricultural policies, in order to take greater advantage of economies of scale within the region, and achieve greater synergy of development strategies.
- The creation of regional institutions to undertake research into common issues of economic, social and environmental development, and contribute to the development of regional and national policy initiatives, such as developing a common system of rules of origin, and regional approaches to dismantling non-tariff barriers.
- Revised provisions for food subsidies, designed to buffer world price fluctuations.
- Strengthened environmental regulation, particularly in relation to water resources, land use planning and controls, and protection of biological diversity.
- Assistance to large and small companies in environmental management and cleaner production systems.
- Promotion of environmentally sound farming practices.
- Strengthening of environmental standards for marine transport and commercial vehicles.

EU development assistance

The development assistance programmes of the Barcelona process already address many of the issues in varying degrees. In order to counter the incremental effects of the EMFTA, these efforts need to be strengthened in particular areas.

- Promotion of collaborative research among all MPCs into the cost-effectiveness of past measures and potential future ones to enhance the competitiveness of MPC industrial companies.
- Detailed research into the social and environmental impacts of agricultural liberalisation in MPCs and southern EU countries.

- Assistance with schemes providing wider dissemination of information on EU product standards and other market access constraints and opportunities.
- Targeting of continued support for stronger environmental management towards measures that are particularly relevant to EMFTA impacts. This may for example include strengthening institutional capacity for integrated economic, social and environmental planning, and integrated urban-rural and industrial-agricultural planning.
- Assistance with strengthening institutional capacity for the use of environmental economics techniques in development planning.
- Coordination of all EU support within the Barcelona process towards common sustainable development objectives, through, for example, inter-agency screening of programme proposals against the priority actions defined in the Mediterranean Strategy for Sustainable Development (MSSD).
- Support for further development of the MSSD, to take account of continuing research into the economic, social and environmental impacts of greater regional integration.

EU support for stronger global governance

- Reinforce efforts to strengthen multilateral governance mechanisms which effectively address climate change and declining global biological diversity, both of which would otherwise deteriorate incrementally under the EMFTA scenario that has been assessed.

Priorities for further study in Phase 3 of the SIA-EMFTA project

The overview SIA has identified a number of priority areas to be considered for more detailed assessment in Phase 3 of the project. These are:

Industrial

- Textiles, transportation equipment, food and beverages, furniture and paper, chemicals/iron and steel

Agriculture

- Fruits and vegetables, fish and seafood, olive oil, cereals, livestock/dairy produce

Services

- Transport, telecommunications, energy, financial, distribution, construction

South-south liberalisation

- All of the priority areas noted above are important for south-south liberalisation as well as EU-MPC liberalisation. Additionally, consideration should be given to detailed assessment of the potential mitigating and enhancing effects of cooperative regional investment in transport and other infrastructure, and regional cooperation on the development of industrial and agricultural policy.

Further consultation

The results of the overview SIA will contribute to refining the EU's position in ongoing negotiations, the design of its development assistance programmes and other parallel measures, and the selection of priority areas for more detailed study in Phase 3 of the SIA project. In order to assist with this, comments and suggestions are invited on the questions identified below. The list is not intended to be comprehensive, and observations relating to other aspects of the study are also welcomed.

- Is there any important evidence of which you are aware that has not been taken into account, such that incorrect conclusions may have been drawn?
- Are there any faults in the analysis which may have led to incorrect conclusions?
- Do you have any suggestions for additional mitigation and enhancement measures which have not been discussed?

- Are there any priority areas which should be given particular consideration for more detailed study in Phase 3 of the project, including any which have not been identified in this report?

Comments and suggestions may be sent to the project email address:

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