

SPS measures lead to high costs and losses for developing countries

by Mehdi Shafaeddin

In the current Doha Round of negotiations at the World Trade Organization (WTO), a lot of focus is given to the negative effects of the developed countries' high agricultural subsidies on the agricultural market access and exports of developing countries.

But the developing countries' agricultural exports are also significantly and increasingly adversely affected by the use by developed countries (particularly in the European Union (EU)) of mounting sanitary and phytosanitary (SPS) regulations. These countries are in fact applying trade-restrictive measures on developing countries' exports. While subsidies are rightly focused on, the Doha Round negotiations have neglected to deal with the SPS issue.

This is unfortunate, considering the high compliance cost and the export losses suffered by many developing countries. For example:

- African countries are estimated to have lost \$670 million in agricultural exports because of the higher EU standard for aflatoxin as compared to the Codex Alimentarius standard.
- The secretariat of the African, Caribbean and Pacific (ACP) Group of states has estimated that the operational costs of complying with SPS regulations represent 2% to 10% of the value of

products exported by ACP countries.

- China is estimated to have lost \$9 billion of exports in 2002 alone due to SPS barriers in the EU, Japan and the US.

Prevalence of SPS standards

The WTO Agreement on the Application of Sanitary and Phytosanitary Measures (hereafter referred to as the SPS Agreement) and the related measures applied by developed countries impose high costs on the exporting developing countries, and thus restrict their export volumes. The stated objective of the SPS Agreement is to protect human, animal or plant life or health by taking "any" SPS measures necessary. These measures are diverse and complicated and often change rapidly. As a result, their implementation is difficult and highly costly, for both the public and private sectors involved in the supply chain for exports, particularly in least-developed countries (LDCs).

The requirements and guidelines of the SPS Agreement entail the application of three sets of international standards, set by the so-called "three sister organizations". These organizations are the Codex Alimentarius Commission, International Plant Protection Convention (IPPC) and the Office International des Epizooties (OIE). They provide technical regulations for a vast number of activities

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in the supply chain of exports of agricultural products which include input, production and harvesting, storage, transport, processing, packing and labelling, port facilities and international transport.

The application of these standards requires various scientific, technical and legal skills and capacities. In the case of plants alone, they include about 50 different activities and measures. The requirements for food products and animal health are also similarly diverse and complicated.

Apart from international standards, governments and enterprises of the importing countries often impose their own additional standards and regulations which are more restrictive than the international standards. For example, the EU has 24 Regulations and directives. A growing number of commercial standards which are even more restrictive than the official government standards are also set by retailers in importing countries, for example, EurepGAP, Tesco and British Retail Consortium (BRC).

Adding to the problem of implementation of the SPS Agreement is a tendency towards the lack of harmonization of the standards and regulations. Different countries implement different SPS measures. For example, out of 154 notifications on tropical fruits and vegetables by the EU, Japan, the US and Canada during 1995-2004, 59% were non-harmonized, and another 19% were only partially harmonized.

Within the EU itself, the measures applied to a product, for example, to fruits and vegetables, may sometimes differ from one country to another. Moreover, the number of maximum residual levels (MRLs) of chemicals, pesticides, etc. set by the EU, the US and Japan is over 22,000, 8,600 and 9,000 respectively, which far exceed that of Codex which is set at 2,500. The new harmonized 1998 EU standard for the maximum level of aflatoxin B1 is 2 ppb (parts per billion) as compared with 9 ppb for the Codex international standard. Such stringent standards may act as a disguised measure of import protection.

Cost of compliance

One implication of such a complicated and stringent standard system is the increased cost of compliance for exporting countries on which the burden of proof falls. The cost of compliance is the sum of all expenses, fixed and operational, accrued to the public and private sectors (farmers and enterprises involved in the supply chain). These costs include

those necessary for adjusting various components of the supply chain, development of the necessary capacity in order to conform to the SPS measures, the administrative cost of control, inspection, testing and certification, and the cost of delays in exportation (e.g., interest charges) caused by the procedures necessary for compliance.

For example, for testing a product, there is a need for initial investment in equipment, training of laboratory personnel and testing officers as well as the cost of accreditation. The operational cost will include maintenance, salaries and the cost of laboratory material. Added to this is the cost of participation in the "three sister international organizations".

When compliance may result in the reduction of exports, the loss of export earnings should also be taken into account. If exports are reduced, there will be secondary costs in terms of the loss of income at the country, farm and firm levels, as well as the loss of employment and household consumption.

The cost of compliance with SPS measures acts like an export tax as far as its impact on export prices is concerned. The difference, however, is that unlike export taxes, which create revenues for the government, the cost of compliance is borne by the country, the burden of which is shared between the government and the private sector. To the individual producers and firms involved, it is similar to transaction costs.

When an SPS measure is used by an importing country as a "disguised trade barrier", it also acts as a quantitative restriction on trade. To defend against unjustified trade restriction, the exporting country has to take defensive measures for dispute settlement, which also requires the necessary information and scientific, technical and legal capacity, thus involving further costs.

It is not possible to quantify all the costs of compliance, but some estimates are available. According to the ACP secretariat, the operational costs of SPS alone "represent overheads of between 2% and 10% of the value of products exported by the vast majority of ACP countries". The secretariat concludes that the SPS Agreement has negatively affected the market access of many ACP countries, particularly in Africa.

Factors affecting cost of compliance

The cost of compliance varies depending on the type of products exported, the destination of

exports, the capacity of the exporting country for compliance and other factors.

When a country is an exporter of sensitive products, it is often more subject to the risk of rejection by importing countries. At the global level, the following products, ranked in order of the proportion of trade affected, have been the most important products impacted by border rejection based on technical standards during 2000-01: fish and fishery products, meat and dairy products, "other processed products", fruits and vegetables and their products and nuts and spices, animal feed and grain, tropical beverages, oil seeds, textiles and fibres, drinks, tobacco/cigarettes and sugar and confectionery.

The destination of exports also affects the cost of compliance. Developed countries, particularly those in the EU, cause the most difficulty in terms of SPS measures imposed on their imports. For example, the negative impact of the difference between the 1998 harmonized EU standard for the maximum level of aflatoxin and the Codex international standard, accepted by some other countries, on African exports of cereals, fruits, vegetables and nuts is estimated to be \$670 million.

Further, the cost of compliance is imposed not only on governments but also on the private-sector producers and exporters. For example, a new EU regulation which came into effect in January 2006 requires the implementation of Hazard Analysis Critical Control Points (HACCP) for the control of hygiene and adherence to Codex rules by exporters; it is assumed that the private operators have the primary responsibility for food hygiene. The principles of HACCP include: analysis of hazards; identification of critical control points; establishment of preventing measures, monitoring procedures, corrective actions, procedures to verify that the system is working properly; and record keeping and documentation. These requirements necessitate investment by the private operator in exporting countries as the EU requires pre-approval of the establishments involved in production and export.

The standards imposed by some retailers in the importing developed countries have nothing to do with the SPS Agreement. Nevertheless, since they are in practice requirements for purchases from other countries, they involve additional costs that small firms and farmers in developing countries often cannot bear. For example, to be able to sell to some UK supermarkets, there is a need to obtain BRC (British Retail Consortium) certification, which requires large investments in upgrading

pack-house facilities. According to the World Bank, the amount of investment for such upgrading for vegetables is estimated to be nearly 11% of an annual sale of \$1.4 million.

Although the cost of compliance is high, the cost of *lack* of compliance is even higher in terms of the loss of exports and its negative socioeconomic effects on the exporting country.

Take the example of China. After its accession to the WTO, the country has suffered from SPS barriers to trade in the EU, Japan and the US. It is estimated that these barriers affected about 90% of China's exporters of foodstuffs and animal by-products and led to losses of \$9 billion in 2002. The experience of China also reveals that the failure to comply with SPS measures will lead to more frequent and closer inspections of future export products of a country by the importers.

Many developing exporting countries have tried to take remedial measures after being alerted that their product was rejected in the port of an importing country as a result of inspection by the relevant authorities. Such problems are mainly due to the lack of control by the exporting country at the port of export and to the failure to deal with the related issues at their sources in the supply chain, including at the farm level. The result has been trade disruption and sometimes the product is also returned to the exporting country, which has to bear the cost of transport and disposal.

The capacity to comply with SPS measures depends on a country's level of development and the organization of production. The lower the level of development, the lower is the capacity for compliance. Similarly, the unit cost of compliance will be higher for small and scattered farm holdings and small exporters.

The LDCs suffer from both these factors – low development level and small size of farm units and export enterprises. According to estimates by the United Nations Conference on Trade and Development (UNCTAD), the cost of initial investment for compliance for tropical fruits alone amounts to about 7% of total exports in the case of Mozambique. For Guinea, the investment cost was also 7% of total food exports. Small exporters such as Mozambique and Guinea are not able to pass on the cost of compliance to importers.

The cost of compliance with the SPS Agreement is colossal particularly when considered in relation to the cost of implementation of other WTO agreements and the income level of LDCs. A 2000

paper by M.J. Finger and P. Schuler estimated that the costs of implementation of "... just three of the six Uruguay Round Agreements that involve restructuring of domestic regulations [on customs valuation, SPS and intellectual property rights], come to about \$150 million [in 2000 prices]... [which] is more than the annual development budget for eight of the twelve least developed countries for which we could find a figure for that part of the budget".

As the income level of developing countries is far smaller, their ability to bear the opportunity cost of compliance is relatively far higher than that for developed country exporters.

The rapid change in SPS measures, regulations and notifications of new regulations is another problem facing developing countries in preparing for compliance. It also imposes extra costs on investors and exporters and creates uncertainty for them.

For example, the total number of notifications submitted to the SPS Committee of the WTO has increased nearly five times, from 198 to 920 between 1995 and 2004. In the case of fruits and vegetables, it increased even more sharply, by over 30 times, from 29 to 888; and for tropical fruits and vegetables, exported mostly by developing countries, it rose from 2 to 197 during the same period.

A country experiencing a disease outbreak may also face additional problems. If the importers discover deficiencies in a cargo of a product originating from a specific country in their random inspection, they may put a ban on imports of that product from that country, causing export losses. For example, in 1998, Saudi Arabia banned imports of live animals from a couple of East African countries, due to the outbreak of Rift Valley fever in the region. The ban was removed after 16 months, but reintroduced even after the end of the disease outbreak.

The cost of compliance increases import prices and thus normally has a negative impact on demand. On the other hand, compliance could increase demand if consumers are prepared to pay premium prices for products which have met certain standards.

Challenges of compliance

As the implementation of SPS measures is knowledge-intensive, it involves a learning process requiring time and training. Similarly, the capacity-building "from farm to fork" also requires a long

period as there is a need not only for a control system throughout the supply chain but also for a change in the method of organization of production and of distribution in the supply chain, including the choice and use of inputs such as fertilizers and pesticides.

Capacity-building is difficult also because of the predominance of small farms, the low degree of literacy, the domination of livestock activities in the pastoral areas, the lack of means of information dissemination and the vast geographical area of some LDCs. Therefore, to enable faster compliance, some countries may attempt to organize large holdings and vertically integrated agro-business (e.g., the case of wine production in Chile). This, however, may have a negative distributional impact and the government should take the necessary measures to offset this effect, for example, by providing extension services to smallholders.

The difficulties of complying with SPS measures have resulted in the redirection of African exports of food products away from the developed countries since the SPS Agreement came into effect in 1995. Over 74% of African countries' exports of food products were to developed countries in 1990 but this ratio fell to 62.3% in 2000 and remained at that level in 2000-03. The decline was even steeper for countries that are not WTO members. For example, the corresponding ratios for Ethiopia were 67%, 60% and 47% for the same years. The result has been slow export growth in these countries.

Therefore, while the cost of compliance is high, the cost of lack of compliance is even higher. Thus, poor countries have little option but to comply with SPS measures irrespective of whether they are members of the WTO. The question is: what strategy for compliance should they follow, to reduce its costs and increase its benefits? A forthcoming paper by the author will try to answer this.

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