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What to watch: European farmers unite in unrest, industrial policy déjà vu in Brazil and ECOWAS put to the test

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In summary

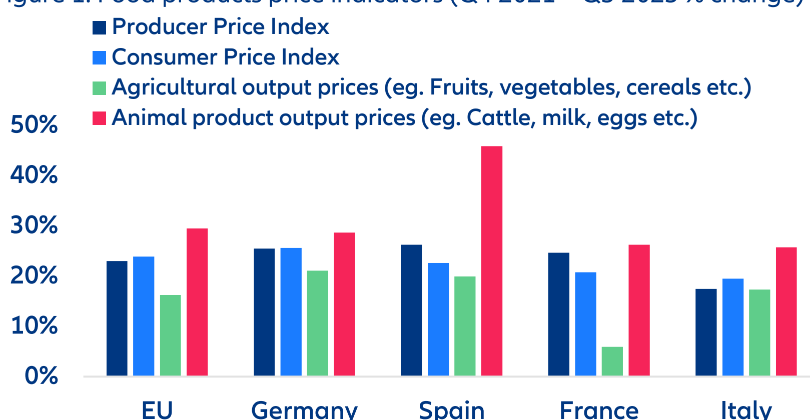
This week, we analyzed three major issues:

- **European farmers unite: the grounds of wrath.** Since the beginning of the year, farmers across Europe have been taking to the streets to protest against squeezed incomes, excessive regulation and unfair competition from imports. The income squeeze is clearly visible: Farmers have not benefited from Europe's record-high food inflation as much as manufacturers or retailers, with real incomes dropping by -12% in the EU and as much as -22% in France between 2022 and 2023. The effects of regulation are harder to measure, but agricultural productivity has been declining rapidly in many European countries over the past five years. In contrast, free-trade has not opened the floodgate to cheap imports from outside the EU as the sector remains heavily subsidized. The ongoing unrest could have political implications for the upcoming European elections, and should nudge policymakers to act at both the domestic and European levels, hopefully without endangering sustainability commitments for the sector.
- **Brazil's new industrial policy: déjà vu?** After the US, the Eurozone and other major economies, Brazil is the latest to announce a hefty spending plan to (re)ndustrialize its economy. The "New Industry Brazil" plan is designed to provide R$300bn (about 2.7% of GDP) in specific credit lines to build up sustainable and digital infrastructure in priority sectors such as agribusiness, health and defense. But this new industrial policy is not so new after all: industrial policy is something of a tradition under Lula's governments, and one with disputed results. A more cost-effective option would be to continue with the reform agenda, implementing the tax reform approved last year and reducing barriers to entry to boost competition. The new industrial plan raises risks on the already fragile fiscal side: we estimate a deficit of -0.75% in 2024 and of -0.5% in 2025, which would bring the debt-to-GDP ratio to an upward trajectory again.
- **Western Africa: Another setback for regional integration.** Burkina Faso, Mali and Niger have decided to leave the Economic Community of West African States (ECOWAS). This decision poses significant economic risks, including a potential EUR3.2bn in trade losses and increased challenges for landlocked economies. The exit could also be interpreted as the beginning of a series of centrifugal moves and test confidence in the CFA Franc, which could in turn put debt sustainability across the region at stake. Note that Senegal, Cameroon and other members of the currency union are currently facing elevated external financing requirements.

European farmers unite: the grounds of wrath

Farmers have not benefited from Europe's record-high food inflation as much as manufacturers or retailers, especially in France: Farmer's real incomes dropped by -12% in the EU – and as much as -22% in France – between 2022 and 2023. Since the beginning of the year, farmers across Europe have been taking to the streets to protest against squeezed incomes, "excessive" regulation and unfair competition from imports, as well as what they perceive as contempt for their profession amongst some politicians amid the green transition. Some demands are country-specific: French farmers, for instance, want to reform food price negotiations, while in Germany the protests were triggered by the phasing out of a tax break on diesel fuel. But the revenue squeeze is visible across the four largest Eurozone economies: Since Q4 2021, producer prices from food manufacturers and food retail prices outpaced agricultural output prices in the EU, with the gap most significant in France (Figure 1). This underlines the fact that farmers did not benefit from rising food prices as much as manufacturers or retailers, though producers of animal output (meat, milk, eggs) did manage to sell at much higher prices than their peers in non-animal products. The unfavorable pricing power results from farmers' low bargaining power, especially in segments with a high concentration of food manufacturing, such as oil & fats or grain & starch in France, and sugar in France, Spain and Italy (Table 1). At the same time, farmers also had to cover higher costs for energy, fertilizers, transportation and storage, as well as rising wages for agricultural workers. As a result, with the exception of Spain, farmers' real net income did not increase in 2023 and lagged the growth in real wages in other sectors of the economy (Figure 2). .

Figure 1: Food products price indicators (Q4 2021 – Q3 2023 % change)



Sources: Eurostat, LGSE Datastream, Allianz Research

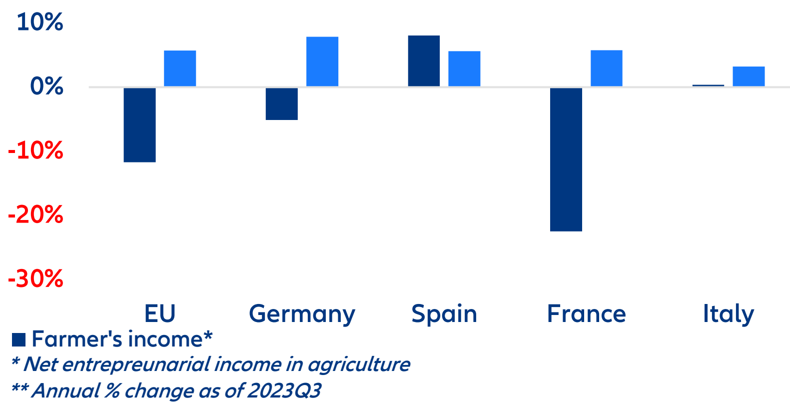
Table 1: Herfindahl-Hirschman Index for food manufacturing sectors in selected European countries

	Spain	France	Italy
Meat	117	160	173
Fish	375	464	356
Fruits & vegetables	133	324	113
Oils/fats	803	4773	315
Dairy	328	234	154
Grain & starch	659	1612	222
Bakery	162	76	252
Other food products	310	454	419
Animal feed	211	283	166
Tobacco	2481	7950	6945
Sugar	4650	2324	3796
Spirits	907	792	821
Wine	139	428	85

Other fruit wines	892	2212	3378
Other fermented beverages	1928	3849	6635
Beer & malt	1688	2260	2771
Soft drinks/mineral water	939	1308	951

Sources: European Commission, Allianz Research. Note: Segments with an HHI greater than 1500 are considered concentrated.

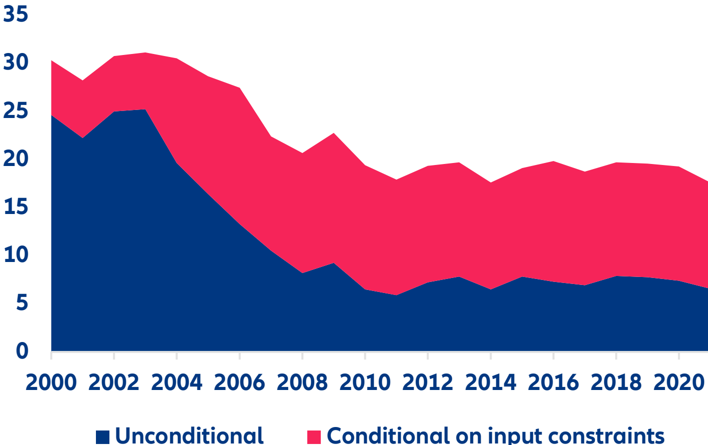
Figure 2: Earnings (2022 – 2023 % change)



Sources: Eurostat, Allianz Research

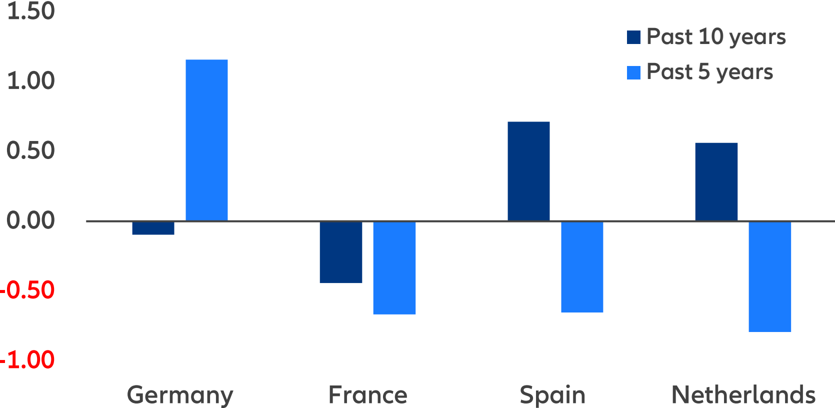
The effects of regulation are harder to measure, but agricultural productivity has been declining rapidly in many European countries over the past five years. Farmers are also protesting against the increasing burden of red tape, paperwork and regulation to comply with what they perceive as an ever-increasing number of environmental and sanitary rules set at the EU level. For instance, the Common Agricultural Policy (CAP) is increasingly imposing mandatory constraints in exchange for subsidies (Figure 3). While the empirical relationship between regulation and economic output is hard to measure, it is clear that above a certain threshold, the costs of regulation outweigh the benefits by imposing elevated costs for businesses and potentially stifling innovation and entrepreneurial activities. There is evidence that this is indeed the case for the agricultural sector: Labor productivity (output per working farmer) has been declining rapidly in many European countries over the past five years (Figure 4). The pace of decline has accelerated in France, as well as in Spain and the Netherlands. In total, the French agricultural sector has lost the most in terms of productivity over the past decade, reflecting the additional layers of regulation implemented by French authorities at the national level, the chief complaint amongst French farmers.

Figure 3: Payments conditional on the adoption of specific production practices in the EU (% of gross farm receipts)



Sources: OECD, Allianz Research

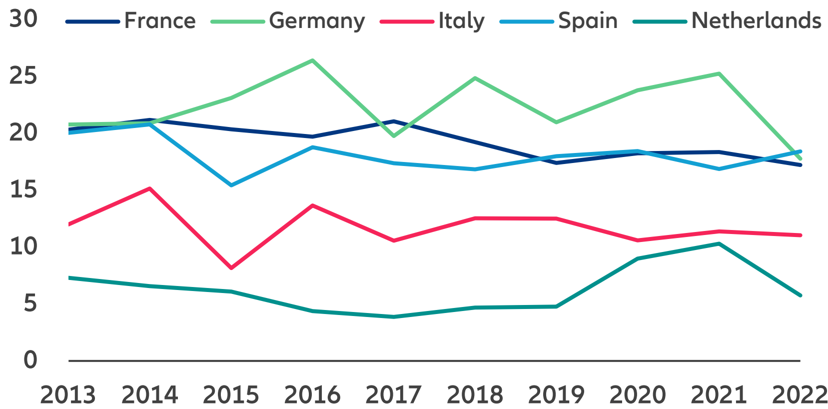
Figure 4: Labor productivity growth in the agricultural sector (% change, annual average)



Sources: LGSE Datastream, Allianz Research

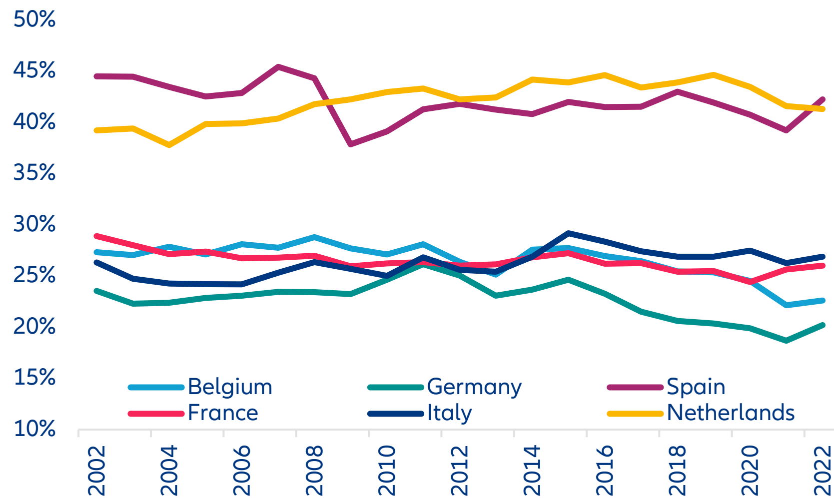
Free trade has not opened the floodgate to cheap imports from outside the EU as the sector remains heavily subsidized, but smaller farmers may yet feel the pinch. While European producers indeed face some forms of unfair competition, for example due to lower regulatory stringency for some products in other regions, they also benefit from significant public support: close to 18% of gross farm receipts stems from producer support in the EU, slightly above the OECD average of 15.9% and well above that of countries such as Brazil (about 3%). Moreover, subsidies (net of taxes) to the agricultural sector have remained above 15% of the sector's value added over the past decade in Germany, France and Spain (Figure 5), though EU countries indeed face higher labor costs than other regions. Despite free-trade agreements with other regions, imports of extra-EU food products have been rather stable in most countries over the last 20 years, suggesting that, as a whole, the EU agricultural sector has not been particularly hurt by free trade. However, smaller farmers may have suffered.

Figure 5: Subsidies net of taxes in % value added, agricultural sector



Sources: LGSE Datastream, OECD, Allianz Research

Figure 6: Share of extra-EU food imports (% of total food imports)



Sources: Eurostat, Allianz Research

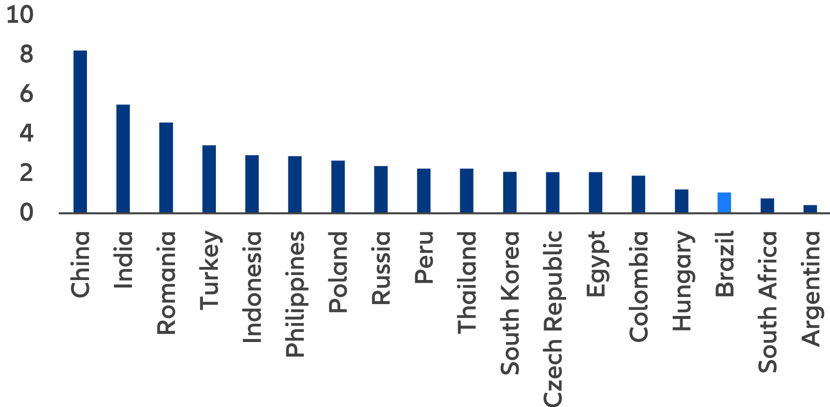
Nevertheless, the ongoing unrest could have political implications and should nudge policymakers to act at both the domestic and European levels. While this is hardly the first time that Europe has faced farmer protests, they could play a role in the upcoming European elections. In 2019, protests in the Netherlands resulted in the formation of the right-wing political party BoerBurgerBeweging (BBB), which promised to address farmers' issues. In 2023, BBB won the provincial elections, following the Senate election, and emerged as the party with the highest number of seats in the Dutch Senate. After securing 4.7% of votes at the November general election, the party is currently in talks to be part of the ruling coalition. This suggests the rise of a new kind of "agrarian" populism in Europe. In this context, increasing farmer discontent highlights the importance of working towards a just green transition. Current and future regulations should be simplified and streamlined following discussions between governments, EU authorities and farmers' trade unions to see where compromises can be reached. Ongoing and future free trade agreement negotiations should also put more emphasis on mirror clauses to ensure that imported products face higher regulatory scrutiny. Finally, governmental checks of the retailers and food industry should be scaled up – a policy already announced by the French government – to ensure that farmers are paid fairly along the distribution chain. Given the high integration of European food markets, further coordination will be needed at the European level as well.

Brazil's new industrial policy: Déjà vu?

Brazil is jumping on the industrial policy bandwagon…After the US, Eurozone and other major economies, Brazil is the latest to announce a hefty spending plan to "neo-industrialize" its economy. The Lula government's "New Industry Brazil" plan is designed to provide R$300bn (about 2.7% of GDP) in specific credit lines – mostly from the National Bank for Economic and Social Development (BNDES) – until 2026 to build up sustainable and digital infrastructure in priority sectors such as agribusiness, health and defense.

…But this "new" industrial policy is not so new after all: industrial policy is something of a "tradition" under Lula's governments, and one with ineffective results. Previous industrial policy programs, very much focused on supporting "national champions", did not generate significantly more investment or growth. Instead, they used taxpayers' money to support or subsidize inefficient and uncompetitive sectors or large industries that did not really need the subsidies. Moreover, the public sector in Brazil is widely considered to be an inefficient allocator of resources, resulting in spending with a very low multiplier effect in the economy. Academic evidence[1] also shows that these policies have had little impact on corporate profitability and productivity in the past. While the new program includes some efficiency-boosting measures, such as reducing the validity of patents from more than six years to two and funding the training of more workers in Brazil's network of technical education institutions, it lacks the measures and reforms needed to increase Brazil's industrial competitiveness and integrate the industrial complex into global value chains. Despite being a major emerging economy, the country lags behind its peers, with productivity growth barely exceeding 1% per year during the boom years of the 2000s and negative total factor productivity growth between 1996 and 2015.

Figure 7: Labor Productivity Growth (%, Annual Average, 2003-23)

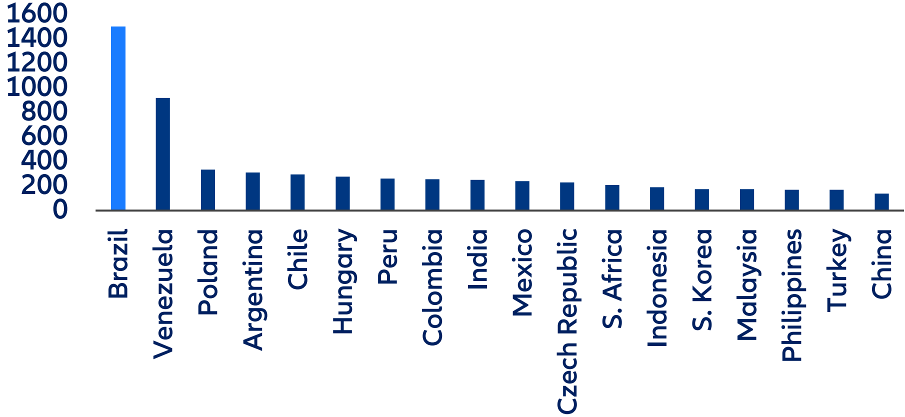


Sources: EIU, Allianz Research

A more effective way to support the industrial sector would be to continue with the reform agenda and enact a series of policy changes. A much quicker and simpler strategy would be to push through the tax reform that was approved last year but is yet to be implemented. The industrial sector is the most affected by tax policy and complex legislation, facing cumulative taxation in production chains and excessive judicialization, for example. In this context, tax simplification could be a great boost for industry. Brazil is also one of the world's least open large economies, which limits exposure to international competition, impeding the assimilation of new knowledge and technologies and stifling innovation and productivity. Reducing domestic barriers to entry would bring big benefits for the industrial sector. Ensuring a more efficient judicial system, improving access to credit, promoting international trade and reducing the large budget deficits that prevent private sector financing and keep interest rates high could also go a long way to boost the industrial sector.

[1] *See e.g. Barboza et al., "What Have We Learned About the Brazilian Development Bank?", FGV, 2020.*

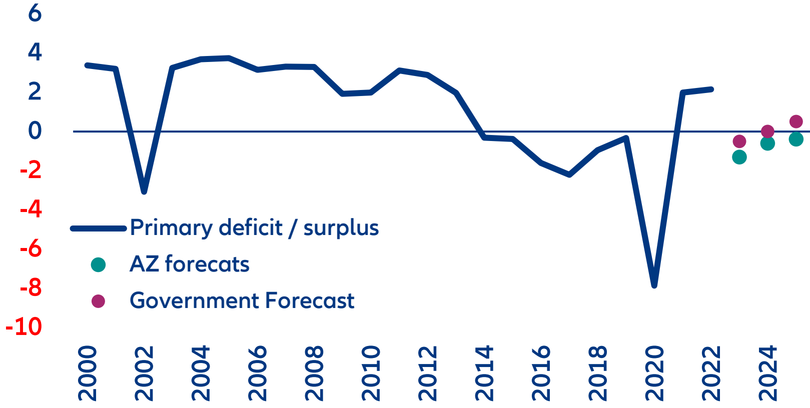
Figure 8: Time taken to comply with & pay taxes annually (hours, 2020)



Sources: Refinitiv, Allianz Research

The new industrial plan raises risks on the already fragile fiscal side. Brazil has a debt-to-GDP ratio of around 90% of GDP, well above the average of its peers in the region (around 60% of GDP). Last year, the government set an ambitious fiscal target of a 0% primary deficit in 2024, which we do not expect it to reach. We estimate a deficit of –0.75% in 2024 and of –0.5% in 2025, which would bring the debt-to-GDP ratio to an upward trajectory again. Hence, there is no room for the government to finance new programs. Doubts remain as to whether it will resort to "creative accounting" as it has done in the past and use debt financing to transfer resources to the BNDES at subsidized rates. Such maneuvers have increased public debt and distorted local capital markets and monetary policy in the past. It should be noted that fiscal data for 2023 show that the central government budget deficit reached 2.1% of GDP in 2023, reversing a surplus of 0.5% of GDP in 2022, and representing the second-largest budget deficit ever recorded by the country - with the exception of the pandemic period. Markets reacted skeptically to the announcement, given the increased fiscal risks. The Brazilian Real (BRL) lost 1.2% against the USD, underperforming all major global currencies and trading at its weakest intraday level since November on the day of the announcement. We expect some near-term market volatility around the fiscal issue as the Minister of Finance will resume negotiations with Congress next month on revenue measures critical to the 2024 zero-deficit goal when lawmakers return from recess.

Figure 9: Back to primary deficit - general government, primary deficit/ surplus, % of GDP



Sources: Refinitiv, IMF, Allianz Research

Western Africa: Another setback for regional integration

Earlier this week, Burkina Faso, Mali and Niger announced their intention to leave the Economic Community of West African States (ECOWAS). Relations deteriorated significantly after the three countries faced military coups (Mali in 2021, Burkina Faso in 2022 and Niger in 2023) that were condemned by ECOWAS. The three states had previously criticized the lack of support from ECOWAS in countering the insurgency led by al Qaeda and Islamic State terrorist groups, which started in northern Mali and spread to the Sahel region, also reaching Burkina Faso and Niger. ECOWAS ultimately suspended these states and Guinea from the organization.

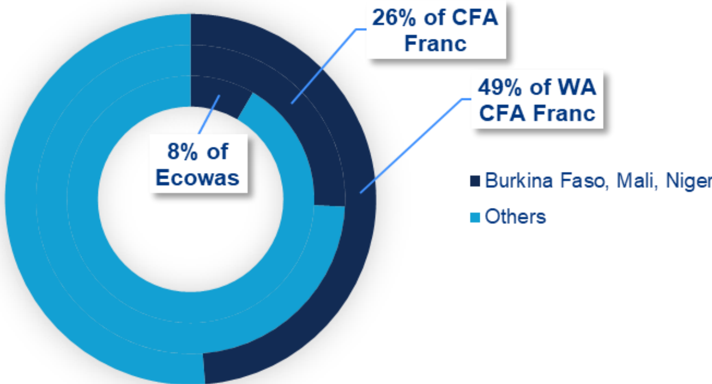
The economic benefits of greater trade integration within the ECOWAS are still far from materializing. But the three ECO-opposers have chosen a path of self-inflicted pain that may have negative spillover effects of EUR3.2bn in trade losses at the regional level, stemming from the new tariffs imposed on their exports (9.9%) and the expected retaliatory tariffs that could reach as high as 5%. The effects on trade are likely to be sizable for the three landlocked economies, with a return to an average duty against ECOWAS countries of 9.9% and additional restrictions on the transit of goods through their territories, which we estimate at +5% on top of regular tariffs (Figure 10). Intra-ECOWAS trade accounts for around 11-12% of imports/exports at the regional level, with differences at the national level (Niger is a notable outlier at around 40%, but for Burkina Faso and Mali it is less than 10%). Burkina Faso, Mali and Niger represent just around 8% of ECOWAS's GDP (19% excluding Nigeria) and some of them have already been hit by import restrictions and border closures by other members. However, the size of the three countries relative to West African CFA Franc (WAEMU) members and overall CFA Franc economies is much larger (49% and 26% of GDP, respectively).

Figure 10: Exit cost for the three countries (EUR bn)

	Exports*	Additional tariff on exports due to ECOWAS exit	Imports*	Additional tariff cost due to ECOWAS exit: +5% tariff scenario	Total cost due to ECOWAS exit
Niger	0.4	<0.05	3.3	0.2	**0.2**
Burkina Faso	3.9	0.4	2.6	0.4	**0.8**
Mali	3.4	0.4	11.4	1.8	**2.2**
Total	7.7	0.8	17.3	2.4	**3.2**

Note: once these countries leave ECOWAS, certain markets would likely adopt the World Trade Organization trade regime, unless they are part of a preferential trade agreement. The simulation is built considering main destination markets and existing trade agreements.
* Includes at least 90% of their total export value in 2022
Sources: Trade Map, World Bank, Allianz Research

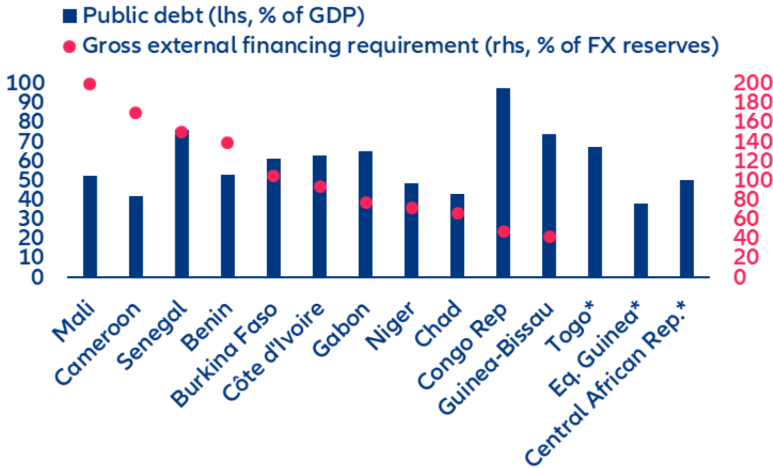
Figure 11: Economic relevance as a % of aggregated GDP



Sources: IMF, Allianz Research

Confidence in the CFA Franc may be considerably endangered if it lost one half of its economic size, along with its relevance as a tool to stabilize the economic and social environment. Capital flight remains a risk since the convertibility of the CFA Franc is guaranteed by the French Treasury, but this scenario is unlikely. In 1994, it did not materialize despite a devaluation of 50% vis-à-vis the French Franc. On the other hand, debt sustainability could be put at stake should confidence in the CFA zone deteriorate rapidly. Senegal's debt repayment, for instance, could be at risk, with public debt of all the other WAEMU countries close to or slightly over 60% of GDP and Senegal's at 81%. Public debt is much lower on average for CEMAC countries, with Cameroon standing at around 42% of GDP and Congo-Brazzaville as the only exception close to 100%. But external financing requirements remain elevated, especially at a time when African countries are still unable to place sovereign bonds at reasonable rates.

Figure 12: Fiscal vulnerabilities across CFA Franc countries

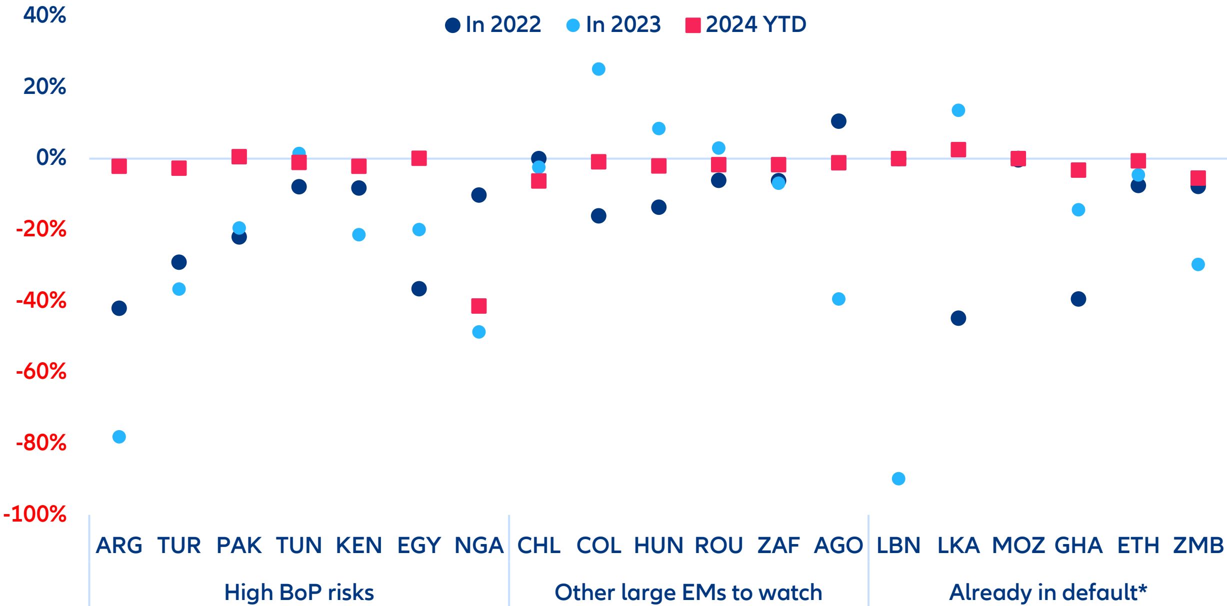


* GEFR not available

Sources: IMF, Refinitiv, Allianz Research

The inability to effectively attract new members and diplomatically resolve regional conflicts suggests that ECOWAS is losing its position as a weighty interlocutor in the region, while the organization's heavyweight, Nigeria, is experiencing another round of currency depreciation that could trigger additional discontent. The inability to prevent or resolve conflicts seems to be the case not only with countries now ruled by military juntas but also more solidly democratic countries such as Senegal: In November, one of the main opposition leaders failed to regain the right to eligibility for the presidential election to be held on 25 February, which remains the most important event of the year for the area. At the same time, an additional focus on domestic issues brought in by the devaluation of the Nigerian naira may divert attention from regional problems and complicate the picture for international investors.

Figure 13: FX performance by year of countries identified at risk



* These includes other countries not included in the BoP risks analysis but that are involved in a default process (either already in a formal restructuring process or in default or selective default); Russia, Ukraine, Belarus, Suriname and Venezuela have not been included for various reasons. Countries identified as risky but that are either dollarized (e.g. Ecuador) or that have their currency pegged (e.g. CFA countries to EUR) have likewise been excluded.

Sources: Refinitiv Datastream, Allianz Research.

These assessments are, as always, subject to the disclaimer provided below.

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