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REFORM OF THE EU SUGAR REGIME AND ITS IMPACT ON DEVELOPING COUNTRIES

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The negative repercussions of the reform of the EU sugar regime on the Irish sugar industry has been well publicised. Eoghan O'Briain analyses the effect this reform will have on different groups of developing countries. He finally concludes that it is not the EU sugar farmers that will suffer most but the poor producers in developing countries.

Introduction

'The Commission's proposal does not take our situation into account in any way. It is completely at odds with EU development policy, the general objectives of the Doha Development Round, and the pursuit of the UN Millennium Development Goals'

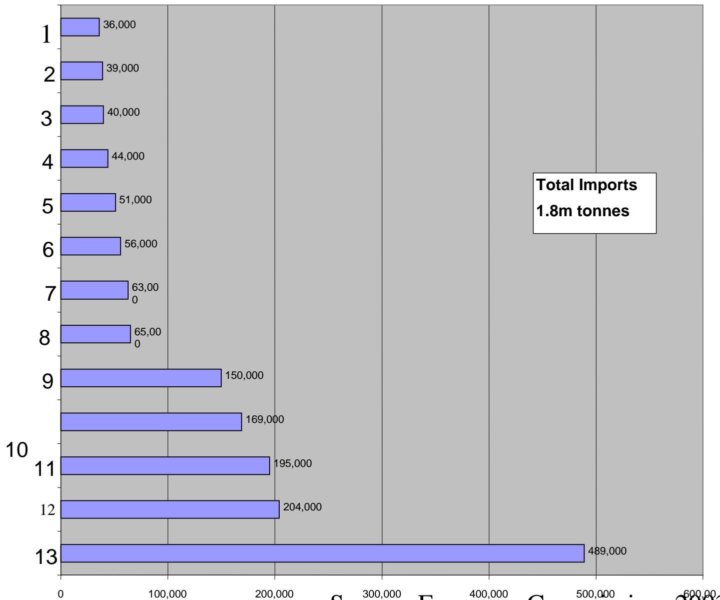
Kaliopate Tavola, Minister for Foreign Affairs and External Trade of Fiji (ACP, 2005b:1)

On November 24th 2005 EU agricultural ministers reached agreement on the details of the June 2005 Commission proposal to reform the Common Market Organisation (CMO) for sugar. I will outline the details of this agreement, before examining its likely impact on various groups of developing countries. This question is important in light of the EU's stated ambition of achieving the Millennium Development Goals by 2015. The essay informs the debate on preference erosion, an issue of major concern to developing countries at the recent WTO Ministerial in Hong Kong. I will examine the reaction of developing countries to this proposed reform, and investigate, whether the EU's package is fair in terms of its effect on developing countries. I will conclude that the EU has neglected its responsibilities to some of the world's most vulnerable economies, in its haste to compensate politically powerful EU sugar farmers.

Pressure to Reform

The Sugar CMO has remained largely untouched since its introduction in 1968. The CMO guarantees a minimum price for sugar, subject to a production quota for each member state. This intervention price is set high enough to ensure that even the least competitive member states can produce sugar. (Chaplin & Matthews, 2005b) The EU intervention price has typically been 2-3 times higher than world market prices. As such many sugar producers enjoy high profit margins, and some developing countries benefit from preferential trade agreements. For quota production export subsidies bridge the gap between world market prices and the EU price, enabling the EU to export large quantities of sugar, although it is a high-cost producer. High import tariffs restrict access to the lucrative EU market, however under the auspices of the Sugar Protocol the EU imports raw sugar cane at the higher EU price from developing countries (18 ACP[1] countries and India).

Figure 1: EU-15 Main Partners for Import Quantities 2000-2001



Source: European Commission, 2003

[1] African, Caribbean and Pacific Group of States.

Legend		
1 Brazil	2 Malawi	3 Serbia & Montenegro
4 Barbados	5 Belize	6 Trinidad & Tobego
7 Cuba	8 Zimbabwe	9 Jamaica
10 Swaziland	11 Guyana	12 Fiji
13 Mauritius		

Pressure to reform the CMO has intensified for both internal and external reasons. Reform should bring the sugar CMO in line with other sectors in terms of improved market orientation, and the shift towards decoupled payments. However it is the EU's need to meet its international commitments that makes the need for reform paramount. A WTO dispute panel ruled in favour of Thailand, Brazil, and Australia in their complaint that exports of C-sugar from the EU are indirectly subsidized, through the generous support for quota production. These non-quota exports must be subjected to the EU's Uruguay Round commitment to limit the quantity of subsidized exports to 1,273,000 tonnes. Therefore the EU can no longer export its excess produce on world markets. The EU faces further pressure to remove export subsidies, and reduce tariffs in the WTO Doha round of negotiations.

The EU's offer of unrestricted market access to 50 least developed countries by 2009 has also made reform inevitable. The Everything But Arms Initiative (EBA) will ensure that tariff-free import quotas are gradually increased, until they are eventually removed. Tariff rates on imports from these countries will be phased out by July 2009. Their potential to expand production, in order to take advantage of high EU prices, is expected to increase by 2009. Imports to the EU should increase, while exports must be curtailed to meet WTO commitments. This anticipated shift in trade patterns must be offset by a fall in EU production. In light of these realities the case for reform of the sugar CMO is unquestionable.

Reform Agreement

The November 2005 agreement (European Commission, 2005b) will cut the guaranteed price for white sugar by 36% over 4 years.[2] Farmers will be compensated through the Single Farm Payment for 64.2% of these price

[2] The price will fall by -20 percent in year one, a further -7.5 percent in year two, a further -5 percent in year three, and a further 6% in year four. (European Commission, 2005b)

cuts. Uncompetitive producers can avail of a voluntary restructuring scheme; € 730 per tonne of past production levels will be offered, if sugar factories exit the industry. This amount decreases annually, and the offer expires after four years. Initially there will be no compulsory quota reductions, as it is hoped that inefficient producers will exit gracefully. C-sugar will be brought under the quota system. Member states, which produced C-sugar, can avail of an additional 1million tonnes of quota production. In order to help ACP countries, which have enjoyed preferential trade with the EU, to cope with the impact of reform a country-specific assistance scheme will be established.

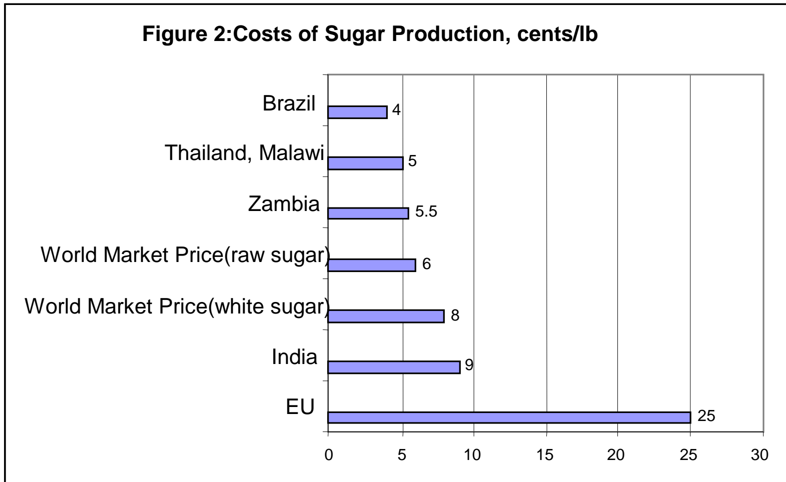
'Since the complexity of restructuring and diversification processes requires a sustained effort, assistance should be integrated into an eight year scheme. An initial budget of 40 million euro has been earmarked for 2006. Further long term assistance will be secured for the period 2007-13.'
(European Commission, 2005a)

The European Commission projects that reform will reduce EU production by 7.5 million tonnes to 12.2 million tonnes by 2012/13 (European Commission, 2005d). Such a drop in production should enable the EU to absorb the anticipated increase in EBA imports, meet its WTO obligations, and to eventually abolish export subsidies. These projections are contingent on success of the voluntary restructuring scheme, which is difficult to predict, as farmers may be reluctant to exit the industry quietly.

Impact of Reform on Developing Countries

The imminent reform of the sugar CMO will affect three groups of developing countries. Competitive developing country exporters such as Brazil, Thailand, Colombia, Malawi, and Zambia stand to gain from reform of the CMO. Despite the inefficiency of its production, the EU exported 6 million tonnes of white sugar in 2000, 15% of world exports. (European Commission, 2003) In the absence of EU export subsidies and sugar dumping on world markets, these countries will be able to exploit their potential to increase exports. They should also benefit from higher prices, as EU policy will not depress world prices to the same extent.

While such competitive producers will clearly benefit from EU reform, the effects on other developing countries are less clearcut, and more troublesome.



Source: The Economist, 2004.

African, Caribbean and Pacific Producers

EU reform will impact negatively on ACP countries, which have enjoyed preferential access to the lucrative EU market for exports of raw sugar cane under the The Lome Convention (1975) and the Cotonou Agreement (2000). This system was designed to secure 1,304,700 tonnes of imported raw sugar cane primarily for British refineries. As EU prices have soared relative to world prices, this scheme has been viewed more as a form of development aid to former colonies.[3] Furthermore seven EU refineries are allowed to import an additional 474,300 tonnes of Special Preferential Sugar from ACP countries and India under the Maximum Supply Needs scheme. Therefore 1,779,000 tonnes of raw sugar exports from these developing countries are eligible to receive the high EU price. Sugar production in many of these countries is relatively inefficient, and may be unsustainable, given a 36% reduction in the EU price[4].

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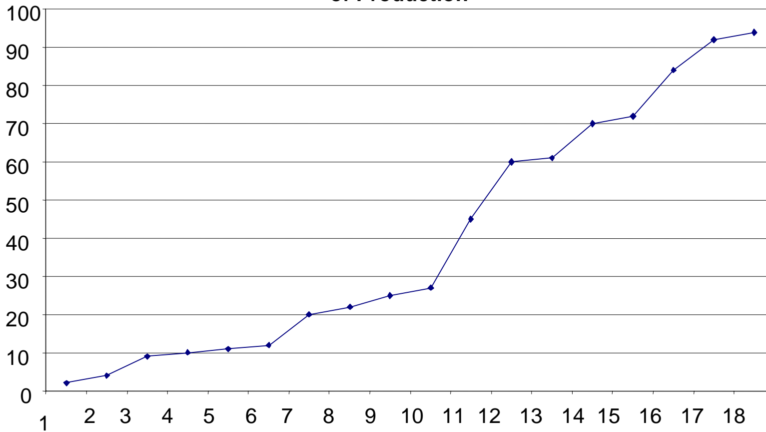
[3] Preferential trade is widely regarded as an inefficient method of development aid. Direct financial transfers would be more beneficial to developing ACP countries.(Chaplin, 2005)

[4] These figures are taken from Chaplin & Matthews 2005b P.3 but I don't see the need for a reference as it is common knowledge. Also EC 2004

Figure 3: Sugar Protocol Countries 2003: Exports to EU as a percentage of Production



Legend		
1 Kenya	2 Mozambique	3 Zambia
4 Zimbabwe	5 Tanzania	6 Congo
7 Madagascar	8 Cote d'Ivoire	9 Swaziland
10 Malawi	11 Belize	12 Guyana
13 Fiji	14 Trinidad	15 St. Kitts
16 Jamaica	17 Barbados	18 Mauritius

Source: European Commission 2005c

ACP countries have launched scathing attacks on the EU's reform package. While recognising the need for reform, they see this proposal as a callous move, designed to load the burden of reform onto ACP countries. Such developing countries are reliant on the sugar industry for employment, and foreign exchange earnings. 'Sugar generates 17% of GDP in Guyana and 24% in Swaziland, while in Fiji sugar production is responsible for 90% of agricultural output.' (ACP, 2005a:1)

Sugar production in ACP nations exhibits multifunctional benefits - plantations "provide vital ancillary services such as healthcare, education and social services in rural districts, while reducing migratory pressure on urban areas." (ACP, 2005a:1, Oxfam, 2004) Sugar cane's aesthetic appeal is important for tourism in countries such as Barbados, and it is also environmentally friendly. Many ACP nations are vulnerable to natural disasters, and potential replacement crops for sugar could not survive tropical cyclones. Reform threatens such benefits.

ACP countries have highlighted the social consequences of the decimation of their sugar industries. Fiji, Barbados, Jamaica, Guyana, Mauritius, Belize, St.Kitts & Nevis and Trinidad are likely to face massive upheavals, and probable exit from the sugar industry in the wake of EU reform. This would have dire consequences for rural employment levels, and may precipitate social unrest. Unskilled rural labourers will struggle to find alternative employment. ACP countries have lambasted the EU for failing to give them sufficient time, with price cuts taking effect from July 2006. Clement Rohee, Minister of Foreign Trade of Guyana and Ministerial spokesperson on sugar for CARICOM, believes that "it is impossible to overstate the devastating impact the price cuts and timescale proposed will have on ACP countries. Sugar industries in many countries will be unable to survive, while in others the so-called reform will inevitably lead to severe cutbacks with disastrous socio-economic consequences." (ACP, 2005b:1)

Although ACP countries have adopted a common stance in opposition to the proposal, some will not be affected as severely as others. ACP countries, which are also less developed countries (LDCs), should be able to offset the ill-effects of the price cut by increasing export volumes, as the EBA Initiative takes effect. Zambia, Malawi, Zimbabwe, and Tanzania fall into this category. If these producers can remain competitive (or if others become competitive) they will also reap the benefits of diminished competition from EU exports in third markets. ACP criticism of the reform has overlooked this opportunity.

As the EU only imports raw sugar cane, ACP producers have been denied the chance to add value to their produce, by developing their own sugar-based food industries.(Oxfam, 2002) Reduced dependence on the EU, and improved prospects in third markets may offer countries such as Swaziland the opportunity to develop the value-added sector of its sugar industry. ACP countries published an alternative proposal, calling for less drastic price cuts implemented over 8 years. These recommendations were ignored, as they preserve the underlying problems with the CMO. However unappealing in the short-term, it may be beneficial for ACP countries to diversify away from an industry, where they are inefficient. ACP representatives have expressed their preference for an EU assistance programme, which would promote productivity gains, and focus diversification efforts within the sugar industry.[5](ACP, 2005a) Perhaps many ACP countries should acknowledge that their sugar industries are unsustainable, and instead of futile attempts to save a rotten industry, should

[5] Sugar industries in ACP countries may be better able to survive, if they can gear production towards alternative uses such as rum or ethanol. In Brazil such activities account for a large proportion of raw sugar production.

embrace reform, and concentrate on restructuring their ailing economies with as much technical and financial assistance as is possible to extract from the EU.

Less Developed Countries

The fledgling EBA Initiative has already yielded benefits for some of the planet's poorest countries. Although efficient sugar producers such as Mozambique, Ethiopia, and Sudan can only avail of small quotas, the stability provided by the prospect of increasing access to the EU market has revived their sugar industries. 'Mozambique is making solid progress in agriculture. Sugar production is now running at more than 200,000 tonnes per year-the highest since the early 1970's' (Economist Intelligence Unit, 2005:1). Investors can make decisions in the knowledge that the price for a certain volume of sugar exports will be guaranteed by the EU.

'In Mozambique and Zambia more than three quarters of the population live on less than $2 a day'(Oxfam, 2004:4). In the case of Mozambique 'the sugar sector was the single largest source of formal employment in the country, employing 23,000 workers in 2001' (Oxfam, 2002:25). Clearly the revival of the sugar industry, arising from access to EU markets, can play a key role in lifting such countries out of their current malaise. In this context it is important to investigate, whether EU reform will retard this vital rehabilitation process.

Under the lower EU price, LDC export revenues will be lower and investment in sugar industries should not be as buoyant, as it would be in the absence of reform. If market access had preceded the fall in sugar prices LDC's would be better placed to attract foreign investment and quickly grow their sugar industries. Nonetheless access to the EU market remains lucrative to these countries, and export revenues will rise dramatically for efficient producers. In the absence of reform, the EU would not be in a position to offer this access. Consider the counterfactual case of a reform proposal, which instead of cutting the guaranteed price, would require EU farmers to reduce production still further, in order to make way for a flood of more competitive imports. Politically such a reform would be unviable.

If a sharp fall in the EU intervention price was inevitable, then this reform can be viewed as necessary to ensure that the improved market access, promised under the EBA Initiative, will not be postponed once again. Furthermore the fact that fewer LDC's will be in a position to export sugar under the EBA may be a blessing in disguise. Lower (although still lucrative) prices will ensure that some uncompetitive sugar producers will

miss out. Perhaps they have no place in sugar production, if they are unable to take advantage of preferential trade. Negative future effects will thus be reduced. It is less likely that inefficiencies in sugar production will become locked into LDC economies, as was the case for ACP producers.

Is this reform fair?

Having examined the likely impact of this reform on developing countries, it is clear that although beneficial to some producers, it entails massive and sudden upheaval for others. Bearing in mind the need for reform of this magnitude, I believe that the EU could do a lot more to ease the hardship of ACP producers. The timescale is far from ideal, allowing ACP producers little time to prepare for a sharp fall in revenue. However it is the EU's perceived lack of interest in the plight of poor farmers that has particularly aggravated ACP countries. The assistance on offer to ACP farmers is derisory in comparison to the generous compensation which EU farmers will receive. Details of the proposed assistance scheme for ACP are yet to be formulated, however the 40million euro earmarked for 2006 is absolutely inadequate, especially when contrasted with the hundreds of millions promised to richer EU producers. Given that the fall in prices may decimate sugar industries in many countries, it is clear that such a scale of assistance package will fail to help ACP countries improve competitiveness, achieve diversification or maintain the social services and rural balance currently supported by the sugar industry.

ACP countries are more dependent on sugar production than EU economies. Due to climatic conditions, ACP farmers may not be able to produce other crops, while EU farmers will use their land in other ways. ACP farmers and factory workers are likely to face greater difficulties in finding alternative work than their EU counterparts. As such it is unacceptable that the EU has chosen to spend virtually its entire current sugar budget (1.3billion in 2004, European Commission, 2005e) on compensating its own farmers, while ignoring ACP farmers. The reform can be viewed as a transfer of hundreds of millions of Euro from farmers in developing countries to EU consumers. If the EU is not prepared to offer direct compensation, surely it could provide more assistance to help these countries cope with the socio-economic upheaval, which many will soon face.

Conclusion

The EU has obligations to three groups of developing countries. Competitive exporters will enjoy more favourable prospects, following the EU's fulfillment of its WTO commitments. ACP producers and LDC's, which currently benefit from preferential trade with the EU, will see their export revenue diminish as a result of this reform. Sugar industries in LDC's will not benefit as dramatically as they would in the absence of reform. However the fact remains that competitive producers will enjoy the fruits of full market access by 2009. While painful restructuring is inevitable for some overly-dependent ACP economies, it is by no means clear to me that this is not in their long-term interests. Dependence on the EU has guaranteed sugar exports but perpetuated a restrictive misallocation of resources. Reform will help reverse this scenario. Although it is not contravening the Cotonou Agreement, the EU should not shirk its responsibility to aid these nations in their efforts to minimize hardship caused by sudden structural change. EU leaders must heed the calls of ACP leaders for increased assistance. While reform is desirable, the negative effects of adjustment in developing countries could be minimized by a more compassionate offer of assistance from EU leaders, who thus far have overlooked poor producers in their haste to appease powerful vested interests within the EU.

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