

Busse, Matthias; Jerosch, Franziska

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Matthias Busse\* and Franziska Jerosch\*\*

## Reform of the EU Sugar Market

*After years of negotiations, the European Union finally reformed its sugar market in November 2005. Unilateral trade concessions, ongoing WTO negotiations and internal pressures were pushing the EU for a change. The following short article highlights some of the key features of the reform and the implications for EU member countries, world sugar markets and countries that currently enjoy preferential access to the EU market.*

The European Union has an extremely regulated market system for sugar. The Common Organisation of the Markets in Sugar is a complex system of guaranteed prices, production quotas, export refunds and import levies. The quantity of production is limited by a complex quota system: the total quota, amounting to 17.4 million tons in 2006, is split among EU member states, which allocate their quotas to local factories and farmers. Creating even more complications, the entire quota is split into the basic quota, called the "A quota", which corresponds roughly to (domestic) consumption and a second, smaller, quota, the "B quota", which acts as a reserve to ensure supply at all times. Normally, B sugar is not used within the Community and is exported with export refunds that fill the gap between the (lower) world market and the (higher) EU prices. Any production above the combined A and B quotas, called "C sugar", receives no explicit support and has to be exported at world market prices.

Within the allocated quotas, since 1993 EU sugar producers have been offered an internal intervention price for raw and white sugar, set at 523 euro and 631 euro per ton respectively. Both intervention prices are far above world market prices: in the period 1998 to 2004, average world market prices amounted to some 160 euro per ton for raw sugar and 190 euro per ton

for white sugar. In addition to receiving a relatively high intervention price, EU producers are protected by high import barriers. Currently, import duties are 471 euro and 469 euro per ton for white and raw sugar respectively, thereby severely restricting sugar imports from countries that do not receive any trade preferences. The total (budgetary) cost of the system has been estimated by the European Commission at 1.7 billion euro in 2004, whereby 75 per cent of the budget are spent on export refunds.<sup>1</sup> Due to a combination of the high internal intervention prices and considerable export subsidies, the EU is a major trader in world sugar markets. In 2004/05, the EU produced 21.5 million tons and exported some 5.5 million tons. The EU is the second largest exporter after Brazil (19.2 million tons) but before Australia (4.2 million tons) and Thailand (3.2 million tons).<sup>2</sup>

The EU provides preferential access to its sugar markets for different groups of countries, of which the African, Caribbean and Pacific (ACP) countries form the major group. Today, 21 out of a total of 77 ACP countries are signatory states of the Sugar Protocol, under which the EU guarantees to buy fixed quantities of cane sugar. The protocol countries receive the same high prices as the European Union's producers. The current total duty-free annual sugar protocol quota amounts to 1.3 million tons. Furthermore, the EU

\* Senior Economist, Department "World Economy", Hamburg Institute of International Economics (HWWA), Germany.

\*\* Junior Economist, Department "World Economy", Hamburg Institute of International Economics (HWWA), Germany.

<sup>1</sup> European Commission: EU Sugar Sector: Facts and Figures, MEMO 04/177, Brussels, 14 June 2004, p. 6.

<sup>2</sup> World exports amounted to 53 million tons in that period.

offers preferential access to the group of least-developed countries within the "Everything but Arms" (EBA) initiative. During a transition period until July 2009, these countries can export raw sugar to the EU duty free within allocated quotas. Thereafter, least-developed countries will have duty and quota-free access to the EU market.

### **Reform of the EU Sugar Regime**

There are various reasons why the EU had to reform its sugar regime. Above all, external pressures were put on the EU because of international commitments within the World Trade Organisation (WTO) and because the EU's sugar policy affects other exporting countries. Not surprisingly, non-EU countries that do not enjoy special trade preferences are fiercely in favour of a reform of the EU sugar system that would grant them better market access as well as reduce total EU production due to an elimination of export subsidies. Australia, Brazil and Thailand launched action in the WTO against the EU sugar regime. In September 2004, a WTO ruling was made, stating that the EU provides export subsidies for sugar in excess of its commitments. Excess export subsidies are provided for 2.7 million tons of C sugar as well as 1.3 million tons of ACP sugar which is re-exported every year. Though the EU claimed that exports of C sugar are not subsidised, the WTO argued that European producers received cross-subsidies through the production of A and B sugar and that the production of C sugar would not always cover production costs at current world market prices. The European Commission appealed against this ruling, but the decision was upheld by the WTO Appellate Body in April 2005.

Another reason for a major reform of the EU sugar market is the ongoing WTO Doha Development Round. The Commission realised that the Doha Round is unlikely to make any progress if the EU does not make any concessions on sugar. Influential WTO members, such as Brazil, fiercely demand considerable reductions in EU domestic production and export subsidies as well as concessions on market access for sugar in the EU and the United States. Moreover, due to extended unilateral concessions as part of the EBA initiative, sugar imports from least-developed countries are likely to increase considerably after full implementation of the initiative in July 2009. Last but not least, the high (budgetary) costs of the current regime have also put internal pressures on the EU to revise the sugar regime.

Following this, EU member countries agreed to reform the common sugar market in November 2005. Until July 2009, the intervention prices will be cut by 36 per cent in four steps, that is, prices for white and raw sugar will decrease to 402 and 335 euro per ton respectively. Though both prices are still above world market prices, the reform implies a substantial price cut. To compensate European sugar farmers and producers, the EU will establish a restructuring fund to support the transition period of four years. In line with previous agricultural reforms, the EU continues to (partly) switch towards direct income rather than production subsidies.

### **Effects of the Reform**

Given these changes in the common sugar market, the EU intends to reduce both domestic production and exports noticeably, thereby fulfilling its commitments within the WTO. According to estimates by the European Commission, total EU sugar production should fall to 12.2 million tons per year, which is equal to a decline of 43 per cent from the 2005 base year.<sup>3</sup> Due to the cut in the intervention prices, inefficient EU producers, such as Greece, Ireland, Italy and Portugal, will have to shut down their production or at least reduce production significantly. Sugar production will be concentrated in the most competitive regions, that is, Germany, France, Poland and the United Kingdom, which are already the largest EU producers. They are expected to remain competitive even at reduced intervention prices. Total EU exports are expected to fall by 4 million tons. After the complete removal of all import restrictions for least-developed countries, imports from these countries are expected to increase by up to 2.2 million tons, whereas total imports may rise by 3.9 million tons.

In addition to the direct impact on EU sugar farmers and producers, the reform will have an effect on all countries presently benefiting from preferential access, such as the Sugar Protocol countries. Though the total sugar protocol quota will remain constant at 1.3 million tons, the price cut applies to their exports to the EU too. Sugar Protocol countries are a rather heterogeneous group with rather diverging production levels and different degrees of dependency on the EU market. Countries like Mauritius and Jamaica, for example, export almost all their sugar to the EU, since EU prices are above world market prices and their quotas

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<sup>3</sup> European Commission: Reforming the European Union's Sugar Policy, Update of Impact Assessment [SEC(2003) 1022], Commission Staff Working Document, SEC(2005) 808, Brussels, 22 June 2005.

## AGRICULTURAL TRADE

**Table 1**  
**Production and Exports of Selected Sugar Protocol Countries, 2004/05**

	Quota	Production	Total exports	Exports to the EU		Income transfer	
	'000 tons	'000 tons	'000 tons	'000 tons	% of total exports	US\$ m.	% of GDP
Mauritius	491.0	598.7	547.4	535.8	97.9	160.2	3.17
Fiji	167.7	334.9	324.3	177.2	54.6	53.0	2.42
Guyana	155.0	331.0	294.3	164.9	56.0	49.3	7.53
Swaziland	118.2	633.7	630.2	158.4	25.1	47.4	2.35
Jamaica	118.6	125.0	135.0	122.7	90.9	36.7	0.55
Malawi	20.8	257.4	116.3	65.7	56.5	19.7	1.30
Zimbabwe	23.4	446.4	175.4	56.7	32.3	17.0	0.35
Zambia	14.4	248.0	137.4	37.1	27.0	11.1	0.25
Côte d'Ivoire	10.2	162.0	45.0	16.0	35.6	4.8	0.04
Madagascar	10.8	32.4	20.0	12.4	62.0	3.7	0.10

Sources: F. O. Licht: International Sugar and Sweetener Report: World Sugar Balances 1995/96–2004/05, Ratzburg, 2005; EUROSTAT; own calculations.

Note: Exports to the EU may exceed the allocated Sugar Protocol quotas, since some of the countries listed in the table benefit from further preferences, such as EBA and Special Preferential Sugar quotas.

are relatively high (cf. Table 1). Other Sugar Protocol countries, such as Swaziland, Zambia or Zimbabwe, which are important sugar producers as well, have much lower quotas and thus a lower dependency on EU markets.

The income transfer from exports to the EU, or the quota rent, provides a rough estimate of the value of current trade preferences. It is equal to the difference between world market and EU prices times the export volume (up to the allocated quota as a maximum). The five countries that currently have the largest quotas, namely, Mauritius, Fiji, Guyana, Swaziland and Jamaica, are also the main beneficiaries in terms of absolute gains (last but one column in Table 1). As a share of GDP, on the other hand, the quota rent has a considerable size only for the first four countries. According to these simple calculations, the income transfer amounted to some 7.5 per cent in 2004/05 for Guyana, which is quite a large figure. Though the per cent figures for the other three countries are somewhat lower, rents in the range from 2.4. to 3.2 per cent of GDP can still be observed.

Importantly, most market analysts (and economists conducting research in that area) expect world market prices to rise if the EU cuts back production and export subsidies, as total supply will decrease. Since the EU is currently a major producer and exporter, the EU reform should have a noticeable impact on world markets, though the precise effect would be difficult to quantify. Estimates for the increase in sugar prices vary within a range of some 5 to 60 per cent, but a number of studies arrive at an increase of around 30

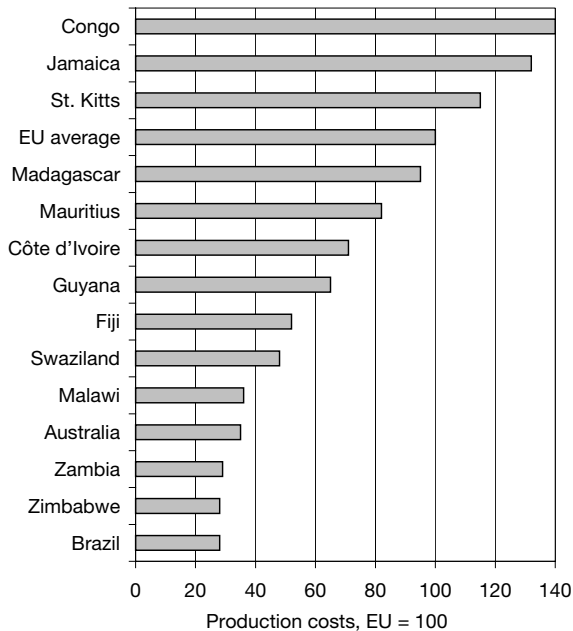
per cent.<sup>4</sup> Yet it should be noted that Brazil has been able to increase production levels (and exports) dramatically in recent years. In the period from 1995/96 to 2004/05, Brazilian exports almost quadrupled from 5.5 to 19.2 million tons. If Brazilian export supply continues to grow at a rapid pace, any price increase resulting from lower EU exports might be insignificant or non-existent.

Nevertheless, if we follow the outcome of the majority of studies and assume an increase in world market prices by 30 per cent, some protocol countries will probably gain in terms of increased market access and higher world prices, while others may face losses. Above all, Sugar Protocol countries that currently have a low EU quota and thus a low dependency, and that are competitive at new EU prices, might take over quotas from those countries that cannot compete at the new (lower) EU prices. This is likely to apply, for example, to Swaziland and Zimbabwe, which will face some losses due to lower EU prices but remain competitive due to low production costs (cf. Figure 1) and, at the same time, gain through the increase in world market prices.

Since Jamaica, Mauritius and, to a lesser degree, Guyana, are high-cost producers, they are likely to be (negatively) affected by the reform of the EU sugar market. They will have to modify current production

<sup>4</sup> Overviews of several studies can be found in: Chris Milner, Wyn Morgan, Evious Zgovu: Would All ACP Sugar Protocol Exporters lose from Sugar Liberalisation?, in: European Journal of Development Research, Vol. 16, No. 4, 2004, pp. 790-808; and FAO: The Impact of Reforms to Sugar Sector Policies. A Guide to Contemporary Analyses, FAO Trade Policy Technical Notes No. 6, Rome 2004.

**Figure 1**  
**Production Cost Index of Selected**  
**Sugar Producing Countries**



Source: Leena Kerkelä, Ellen Huan-Niemi: Trade Preferences in the EU Sugar Sector: Winners and Losers, Helsinki, August 2005.

structures and technologies to stay competitive at lower EU prices. Though important for computing the net impact of the reform for various Sugar Protocol countries, these so-called dynamic effects are very difficult to quantify. Empirical studies tend to neglect the dynamic effects and concentrate on the static impact of the reform.<sup>5</sup> Since no empirical study incorporates all relevant effects, including specific regulations and changes for the different groups of developing countries, we refrain from reporting such results.

In contrast to most Sugar Protocol countries, least-developed countries are likely to benefit from the EBA initiative, since they will have unlimited access to the EU market after July 2009. In addition to duty and quota-free market access, they will receive the new EU price for their total exports to Europe and thus have a strong incentive to export their entire sugar production to the EU, if European prices are above those on world markets. They would even have an incentive to import sugar for domestic consumption from abroad. Six Sugar Protocol countries are also least-developed countries, that is, Democratic Republic of the Congo, Madagascar, Malawi, Tanzania, Uganda and Zambia.

<sup>5</sup> See, for example, Chris Miller et al., op. cit.

Similar to other least-developed countries, they can take advantage of the EU's EBA initiative. In the case of significant trade diversion effects, the welfare losses resulting from lower EU intervention prices are likely to be reduced considerably or even be converted into welfare gains for these five countries.

Yet the principal winners of the reform are those countries that are large exporters and low-cost producers and have a low dependency on EU markets. Above all, Brazil is not only the largest sugar producer in the world, it has the lowest production costs and is able to increase production levels noticeably as well. Brazilian sugar farmers will benefit enormously from the expected fall of EU sugar exports and the possible increase in (world market) prices, as they are in a position to increase their world market shares and enlarge their profit margins to a large extent. In a similar fashion, Australia will benefit as well, though its output and total exports are much lower in comparison to Brazil.

#### Recent Increase in Sugar Prices

Even before the EU reform enters into force, world sugar prices have already risen. As a result of the persistent increase in oil prices, demand for alternative energies increased drastically during the last couple of months. The alternative use of ethanol, which is produced from sugar cane, has had a strong impact on world sugar prices. At 329 and 350 euro per ton for raw and white sugar respectively in January 2006, world sugar prices reached the highest levels in 25 years. Given the upbeat outlook for oil prices, it is expected that sugar prices will also stay relatively high. Since a major reduction in EU exports will further increase sugar prices, the gap between world market and the (new) EU intervention prices would soon diminish, thereby reducing or eliminating any quota rents for Sugar Protocol countries.

In sum, against the prevailing opinion the reform of the EU sugar market through a decrease in the intervention prices and lower sugar exports does not benefit or disadvantage developing countries uniformly. Rather, the impact will be felt quite unevenly, with Mauritius and Jamaica as the likely losers with considerable negative effects, moderate effects in a few Sugar Protocol countries, and positive effects for the EBA countries. Finally, given current high prices, any negative effects will soon be mitigated, since the large majority of sugar producers will most probably enjoy handsome gains for the next couple of years.