THE IMPACT OF ONGOING POLICY REFORMS AND STRUCTURAL ADJUSTMENTS ON THE WORLD SUGAR MARKET

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It is now 2 years since FAO's last big Conference on Sugar held in Fiji in October 1997 and in this period there have been two developments of note that will form the basis of my paper today. The expected launching of the next round of multilateral trade negotiations and the major turnaround in the world sugar market - the collapse of prices to under half what they were 2 years ago. Both these developments are vitally connected with the subject of ongoing policy reforms and structural adjustments, which is the topic that I have been asked to discuss.

I shall start with a look backwards, to what has widely been considered over many decades to be perhaps the main problem of the world sugar market - its instability compared with other prices. Limiting price instability was the objective of the five International Sugar Agreements with economic clauses. Reducing price instability lay behind and still lies behind national sugar policies such as price bands and variable tariffs but is also shown by the revealed preference for price stability of many governments that introduce specific policies to deal with periods of particularly weak prices or shortages.

Yet turning back to the 1997 Fiji Conference there was quite a lot of discussion of what appeared then to be a trend towards improved price stability. Reasons were advanced for the improvements that had seen world prices fluctuate around 11-13 cents per pound since the late eighties. Some of these reasons are still valid, the increase in the share of "free market sugar" and the policy reforms towards a more open system but it must always be remembered that the changes wrought by policy reforms tend to be slow moving and the effects are often dwarfed by factors outside the sugar policy makers control. In the current market three such factors have been operating. Weather conditions is always one of these and crops have indeed been good in the past 2 years. In addition, macro-economic developments in the last two years have led to some quite significant effects on the sugar market. Devaluation made several sugar exporters much more competitive than before 1997/98 - Brazil, and Thailand spring to mind - while the economic problems that afflicted a number of sugar importers led to a weakening of import demand and here the case of Russia springs to mind. Although I'm no longer sure that this is such a good example, (see Mr Ahlfeld's paper). But the third factor in the market downturn has been with us for a long while now and was only latent in the early and middle nineties and this is of course the working of national policies.

In preparing for this paper I have read a number of reviews of national sugar policies and coming as I do from many years working on the cereals - oilseeds-livestock commodities, I was quite struck by the complexity of national sugar policies. The overall impression is that the weight of policy interference is to boost production and curtail consumption. Subsidies to producers measured by the Producer Subsidy Equivalent (PSE) are mainly positive and consumption is taxed in the developed countries and even for those countries for which such statistics are not collected, protection tends to be positive as witnessed by the generally high tariffs on sugar. Thus, the thrust of policy is to bolster production even in years when yields were good and economic conditions unfavourable to demand. An additional factor which appears to be prevalent in the sugar sector is the practice of differential pricing whereby an exporter charges different prices in different markets. At one extreme this can amount to dumping but even without reaching these limits it makes the market hard to understand and predict.

This point leads me naturally into the second major development since the Fiji conference, namely the next round of multilateral trade negotiations. Now after what happened in Seattle you could be justified in being rather sceptical but in my view there will be negotiations on agriculture and they will start fairly soon. The negotiations will presumably last 3-4 years until the Peace Clause - Article 13 of the Agreement on Agriculture - starts to put time pressure on countries to conclude. It should be recalled that almost all countries have a concern that protection against e.g. countervailing duties runs out by end 2003 unless negotiations extend the Peace Clause. Although this is probably of greater concern to the developed countries that use, after all, more subsidies, it is also of concern to developing countries that widely use *de minimis* subsidies as well as investment and input subsidies under the Uruguay Round's special and differential treatment provisions. If the Peace Clause is not renegotiated, all the subsidies will be open to challenge in the WTO and trade disputes could proliferate.

More than for purely legal reasons countries have interests in the negotiations of a substantive nature. Certainly developing countries would hope for improved access to the markets of developed countries with reductions in tariff peaks and in tariff escalation where it still exists. But it should also be noted, as Ambassador Osorio, Chairman of the WTO Committee on Agriculture pointed out that the United States is running large trade deficits and will be looking for improved market access to help reduce its trade deficit. The Cairns Group will be similarly looking to negotiations to pursue the agreed long-run objective of the Agreement on Agriculture, which is to provide for "substantial progressive reduction in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural trade". The EU will no doubt be seeking to lock-in its own ongoing reforms into the new negotiations while probably seeking some clarification on the thorny issue of genetically modified organisms - another area that Ambassador Osorio has identified as rising quickly on the agenda. Finally, there are a number of countries that wish to make sure that the reform programme should fully reflect non-trade concerns including food security and the need to protect the environment. Sometimes these concerns are part of the wider concern to see the multifaceted functions of agriculture are adequately reflected in the reform process.

Thus, in my view serious negotiations are likely to take place on some of the main issues facing world agriculture which to recap are:

- First, the prevalence of considerable distortions in agriculture, production and trade, mainly, but not exclusively, in the developed countries.
- Second, the rising concerns over GMOs and other food quality considerations.
- Third, the fast rising share of processed agricultural products in world trade and hence the issue of tariff escalation.
- Fourth, the development needs of the developing countries that need to become a leading focus of the new Round.
- Fifth, the non-trade concerns particularly food security and protecting the environment have been of major concern to the international community in other fora and will need to be reflected in the negotiations.

In all these areas, sugar figures prominently and the rest of this paper will explore these connections, which are divided into general issues and special issues.

Regarding the general issues, the first is the question of meeting the long run objective of "substantial progressive reduction in agricultural support and protection". It is widely agreed that sugar was one of the sectors where rather little change occurred as a result of the Uruguay Round despite the fact that the sector is heavily affected by national support policies. FAO's recent assessment noted that "concessions on market access by the major consuming developed countries were limited". "The reduction in subsidized exports was not expected to have much effect as these exports only accounted for 5% of world trade". "The main stimulus to sugar trade was expected to come from tariff reduction in the developing countries" and finally the recent changes in world sugar markets were more to do with favourable weather, currency devaluations and weaker import demand in Russia and China than Uruguay Round related changes. So, when negotiators turn to their mandate, deriving from Article 20 of the Agreement on Agriculture to review the experience to date they will find that the effects of the reduction commitments are few and small. Therefore, as there continues to be extensive support and protection in the sugar sector, it is highly likely that sugar will be under pressure to cut the levels of support and protection that it currently receives.

The second general issue, which is closely connected to the first, is that what happens to sugar also depends on what happens in other sectors. Sugar being a major crop, its future can be deeply influenced by reform in other crops. If say the support prices of cereals fall by more than the price of sugar, sugar will become relatively profitable. This can even lead to an increase in sugar production if the price cuts for other crops push down the costs of arable land and farm machinery. Such "perverse" effects can also be observed when the overhead costs of production are subsidized with so called "decoupled" payments while direct market price support is reduced. Again, if the subsidy to overheads is big enough so that long run marginal costs of production fall, lower prices are compatible with higher sugar output. The way in which sugar policy influences the balance between sugar processing and sugarcane or beet production is also of interest. If sugar refining receives different subsidies to those received by sugar farmers then reduction in one type of subsidy rather than another can affect the final level of sugarcane or beet production. The case is easiest to see when refined sugar gets different support to raw sugar - the location of the refining industry being the result. Now, even if some of these arguments sound perhaps a trifle academic, there are concerns expressed that "decoupled" payments are not really decoupled at all, especially in the longer run, so that the type of reduction in support and protection as well as the relative extent of reduced subsidies, commodity by commodity need to be watched. I need hardly remind a sugar audience that HFCS and ethanol owed quite a lot of their expansion to protection in other sectors. Therefore, changes in protection in other sectors can affect HFCS and ethanol production from sugar too.

The third general issue that I wish to raise is the special role of developing countries in the world sugar market. They account for over two-thirds of production and around the same share of trade. Many of these countries themselves practise development policies that either protect or in other ways influence the price signal provided by the world market. Moreover, it's safe to say that most of the countries that receive preferential access to markets in the EU and the United States pass on the higher prices to their farmers. Thus, one way or another, it is not just a question of reducing protection in the industrialized countries but also what will happen to policies in developing countries that will affect the final impact of trade negotiations on the world market. In other words, the developing countries have a major role in reform of the world sugar economy. Even if the EU and the US completely reformed their policies a lot of protection would remain in the world sugar market. In this context it is always worth recalling that some major players in the world sugar market are not WTO members yet. So we can conclude that even if the industrialized countries, members of the WTO, do make reduction in their support to sugar, the market place will also be heavily affected by whether developing countries and non-WTO members also reform their sugar sectors.

To summarize on the general issues, it seems likely that sugar will figure in the negotiations but that the impact of changes in this sector depend on changes in other sectors, in the way decoupled payments are handled and on the extent that reforms take place world-wide and not just in the industrialized countries.

Turning now to the special issues, I should like to pick out four matters that are likely to be raised in the negotiations where special thinking is required. These are food security, environment, preferences and the question of price pooling.

First, as will be said by others, sugar is a food and therefore food security automatically relates to sugar. Admittedly, for many countries it is also a way of earning a living, of generating export earnings but that is true of other foodstuffs too - think of vegetable oils and rice where developing countries are major exporters as well as being importers. Food security is a mandated non-trade concern for negotiators in the upcoming Round. Therefore, whatever the outcome on how food security figures in the negotiations this will have implications for the sugar sector. In what follows, I wish to make two main points -

first the connection of the World Food Summit to the negotiations at Geneva and secondly the possible ways in which food security may fit into those negotiations.

The outcome of the World Food Summit, as pointed out by Aldington in his paper[23] for FAO's recent conference on this subject at Geneva, needs to be seen as a whole - all the commitments have a bearing on food security - but three commitments are of the greatest relevance to the food security international trade nexus. These are Commitment 4 on trade, Commitment 3 on sustainable production and Commitment 2 on access[24]. I shall just highlight a few points that I believe have a bearing on the present debate. First, although trade contributes to food security by its positive effects on economic growth, income and employment, the Summit recognized that such benefits might not reach poorest as that policies are needed "to ensure that all including the poor benefit".

The Summit also urges the mutual supportiveness of trade and environmental policies for food security recognizing the possible antagonism of trade and environmental policies. The Summit also addresses concern relating to food safety and sanitary requirements in trade as well as the need for reliability of food supplies on world markets. The concerns of food importing developing countries, particularly the Least Developed and Net Food Importing Developing Countries are addressed. Commitment 3 of the Summit is concerned with the means to expand food production with sustainability. Aldington summarizes the message as being "human-centred, gender-sensitive, participatory, resource conserving, small scale, local knowledge using, bottom-up agricultural and rural development" of which food security is an integral part. Commitment 3 broadens the concept of food security to focus on equitable and equal access to production resources such as land, water and credit. Underlying this concern to the need to focus attention on "vulnerable and disadvantaged individual, households and groups".

Aldington concludes by asking a number of questions on trade and food security which warrant some emphasis. How to ensure that the overall gains from trade benefit the poorest; how to ensure that trade improves the physical access to food by all; how to ensure that production and trade do not lead to over-exploitation of natural resources; how to ensure that trade flows are reliable; and how to ensure that imported food products are of acceptable quality and safe to eat.

You can easily see that these considerations, which only touch on the range of issues relating to food security and trade raised by the World Food Summit, give much to be pondered on. How can the complexity of food security issues be reduced to some negotiable and, let it be hoped, single set of rules that influence trade. Personally, I do not see how this can easily be reduced to a concept like a target rate of self-sufficiency in food, or to having domestic food aid and food stocks in the Green Box[25]. Most developing countries do not have governmental resources adequate to pay for such an approach to food security. This brings me to the second aspect of the food security issue, its conversion into rules and decisions by the forthcoming trade negotiations. The sort of ideas convassed largely focus on making expenditures and policies that otherwise disrupt market signals exempt from reduction commitments. This could come about by allowing price and input support for food production to be exonerated from reduction commitments. Probably this would have to be limited to developing or food-deficit developing countries with a consolidation of existing exemptions. Reducing negative protection on food production could perhaps be considered a credit item. The question of developed countries would of course loom large in any such negotiations which may eventually make "food security box" impossible outside of a "development box" framework. The other food security issue relates to the reliability and stability of world markets. Developing countries did not get much by way of safeguards for food imports in the Uruguay Round as the Special Safeguard Clause which does provide automatic protection against import surges or particularly low prices was only available to countries that tariffied, which most developing countries didn't do. Other safeguards are slow and expensive for small importing developing countries to invoke. Improved safeguards as a quid pro quo for further market opening may therefore be on the agenda. The case is even stronger if the much reported asymmetry between the rapid rise of food import compared with a slow increase of agricultural exports following liberalization turns out to be true. We need more evidence on this point although the fact that the aggregate value of food imports by developing countries rose between 1995-97 and 1992-94 by 39 percent against a rise of 33% in total agricultural exports lends some weight to the point.

In all these ideas - a food security box - special safeguards for food imports and perhaps special funds for the Least Developed and Net Food Importing Developing Countries - for food one should also read sugar.

This brings me to the second point - the need for negotiations to take into account protection of the environment. The concerns of sugar producers here need to focus on the following points. In the first place, sugar production has an effect on the environment probably both negative and positive. In so far as these concerns are of domestic nature, it is up to the sugar producers themselves to put in place appropriate policies to internalize negative or locally positive external effects. Insofar as they are transboundary, for instance sugar fields serving as a carbon sink, then the rights and duties should be set in an appropriate international environmental agreement. Something perhaps can be made of the idea of emissions permits where sugar producers get credit for the role of sugar lands as carbon sinks, but I'm not an expert in this area and it takes us some way out of the WTO negotiations. Indeed the whole question of forests acting as long-run carbon sinks has recently been challenged. The second area where environmental protection could enter the trade debate is via trade measures taken by importing countries in pursuance of their own environmental agenda. I think here of output from certified sustainable production systems but this broaches some tough problems for a trading system that has concentrated on rules governing

[23] Food Security and the Forthcoming Trade Negotiations. "Key Issues Raised by the World Food Summit" by T.J. Aldington presented at FAO's Symposium on Agriculture, Trade and Food Security, Geneva, 23-24 September 1999.
[24] Rome Declaration on World Food Security and World Food Summit Plan of Action, Rome 13-17 November 1996.
[25] The Green Box refers to agricultural support that is permissible in that it meets certain criteria. Expenditures on such items have not to be reduced.

the trade in products not generally discriminating among products according to the way they are made. A related issue is certified organic production methods or the "fair trade" labelling of products.

The third special issue that I wish to examine is the question of preferences. It is well known to be a major concern for a large number of sugar exporting developing countries. Trade liberalization by making reductions in the Most Favoured Nation (MFN) tariff reduces the value margin of preference arrangements. If this is linked to a fixed volume of imports benefiting from the preferential margin, the total value of the preferences declines on trade liberalization. Notice, however, two points in this argument that bear a moment of reflection. A decrease in preference margins could be made up for by either an increase in the volume imported under the preferential scheme, especially possible if total imports of the liberalizing country rise or it can be made up by a rise in the value of the exports by the preference receiving countries to other destinations. Both are possible ways in which the effects of trade liberalization on the value of sugar exports from ACP and other preference receiving countries could be offset partially or in all. Professor Wohlgenant's study sheds some light on the second point - that usually trade liberalization would not lead to sufficiently large price increases on non-preferential exports to offset margin losses but that there are cases where it could work out and that it always offsets some of the losses. On the other option - an increase in the tariff quota to preferential exporters has not been much explored but is consistent with a large rise in imports by the liberalizing markets. Of course it would not be of use in the case of complete liberalization but I assume no one is thinking that this outcome will transpire in the upcoming round of trade negotiations.

But to be realistic these two sources of offsetting gains are unlikely to do the trick. One must face up to the quandary of the preferential sugar sellers. They are likely to suffer from a liberalization of the sugar sectors in the EU and the United States, but gain from liberalization elsewhere.

What can they do? Well, clearly measures to cut costs in the preferential exporters would help and I'm interested in the FAO papers showing where cost savings could arise - cane yield, sugar yield and manufacturing costs. Obviously, work is necessary on all fronts. The more a preference receiver relies on the world market, the greater the price boosting effects of trade liberalization would translate into offsetting gains. Another possibility is of course diversification but I appreciate the difficulties here even if much could be done if, as FAO showed a few years ago, the banking sector were in a better position to promote new diversification ideas. In the work we did for a possible African Diversification Fund, we identified the costs of vetting project ideas as being a major constraint. Experience suggests that the farmer and entrepreneur can generate good ideas but before they become bankable a long, costly and often inefficient chain of processes and steps has to be undertaken. An international fund to backstop project preparation for diversification could really help.

Yet another possibility is to develop the market for by products, joint products and value added products - bagasse and rum spring to mind but also the host of refined sugar products. Having a processing industry in a sugar producing area boosts the demand for the local raw material in most cases. On this, the question of tariff escalation needs to be examined carefully. But the issue is not just market access, we also need inward investment of the processing industry. To do this, national sugar development policies are required. A related issue here under preferential arrangements and regional trading agreements is the rules of origin on local content but on this point we have to be careful: too liberal rules of origin could work against the interest of local farmers even if the processing sector would benefit. Too restrictive rules of origin under a regional or preferential arrangement of course can kill off the development of the processing industry. This is a difficult point of balance.

We should not be too pessimistic on the score of doing something about the loss of preference margins but we must recognize that it is likely that a deep cut in protection in the preference giving countries could most probably cause a net loss to many of the preference receivers and hence while all the positive steps I have suggested should be examined at the end of the day, some special attention will have to be given to the preference-receiving sugar exporters if the gains from an expanded world trade don't pass them by.

Finally, I would like to say a few words on a more technical issue that could surface in the negotiations. This is connected with state trading. I do not wish to go into the merits or demerits of state trading *per se* except to note that often there were good reasons why they were set up originally and that like all policies after a number of years it is not unreasonable to re-examine them. Nor do I wish to get involved in the exceptionally difficult task of judging whether they act on commercial considerations and whether the mark-up is fair etc. No, I would like to concentrate on the question of export boards and the equivalence of their behaviour to purely private traders. In particular an interesting widely used technique employed by many countries is to establish a para-statal body with monopoly of export sales. This can give rise automatically to the charging of different prices in different markets - i.e. differential pricing. It can arise whenever an exporter has a marketing or transport advantage in another market so that its net returns from selling to that market are higher than selling to distant markets. If the results are pooled so that the farmers get on average a higher price than that received on the marginal destination there is nothing wrong with this procedure. But it is also true that if subsidies are channelled to the para-statal, it can offer targeted lower prices to some markets rather than others. Reducing export subsidies is part of the achievement of the Uruguay Round Agreement on Agriculture. The in-between case is where the exporter has special price advantages or preferences in one of the markets to which it sells its sugar. Even though this is akin to a subsidy, I do not believe that this should be so considered, as the same result would obtain, in the absence of state trading with preferences, providing the private trader did not violate anti-dumping rules. In other words, if a para-statal body traded without export subsidy and without using practices that could lead to anti-dumping cases, by selling sugar at different prices in different markets, whether or not due to preference arrangements, this should not be considered as acting against the spirit of the WTO rules.

To conclude, I should like to summarize briefly the main points relating to the next round of MTNs. I believe there will be substantive talks and that sugar will be on the agenda in view of the widespread use of policies that provide support and protection. Sugar people should keep an eye on negotiations on other competing products and rule changes in other areas, and should look beyond changes in the policies of the industrialized countries. The particular issues that I wish to underscore are the need to be very careful about how food security gets included in the negotiations - sugar being a food - and how environmental concerns might also have some, lesser bearing on the outcome for sugar. I would agree with the preference receivers that even with all the best policies in place - and they are not - several of them stand to lose from deep cuts in protection in the preference giving markets and that, for food security and general welfare reasons, losses by the poorest are not an acceptable outcome of trade negotiations unless there is quite clear and provable compensation in the deal. Finally, I believe that the state trading debate should be watched so that sugar exporters using justifiable practices of subsidy free price pooling are not penalized by possible rule changes. Whatever the outcome of the forthcoming round of trade negotiations, the next few years will test the skills of the sugar policy makers to the full.