The Interaction between the EU's Domestic Policy for Sugar and its Imports of Sugar from the ACP and Least Developed Countries.

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I am honoured to have been invited to address this conference. I would never claim to be a real sugar expert but I have always had a close interest in the sugar trading relationship between Europe and the ACP Developing countries ever since I was present at - and took a minor part in - the final stage of the negotiations that led to the conclusion of the Sugar Protocol to the Lome Convention in 1975. Indeed, even before then I had some acquaintance with sugar as, in late 1970, I took part in the first stage of the negotiations that eventually led up to the agreement on prices for what proved to be the last price period of the Commonwealth Sugar Agreement, an Agreement whose terms inspired many of the detailed provisions of the Sugar Protocol.

For this reason, I was pleased that, despite changes in my other responsibilities during the 13 years in which I was Deputy Director General of the Agriculture Directorate of the EU Commission, I managed to retain responsibility for representing the European Union in its negotiations with the ACP. I had the great good luck that these 13 years - from the beginning of 1990 until 2002 - were ones in which, thanks to the stability in the EU's sugar policy, we had no major problems to overcome and it was even possible in 1995 to negotiate additional access under an the Agreement on Special Preferential Sugar.

But this tranquil situation was too good to last. As I said in a speech I made to ACP Sugar Ministers in 2001, I could see that we were heading for a zone of turbulence. In the light of the way events have unfolded since then, this was an understatement. The Sugar Protocol provided the ACP sugar producing countries with a guaranteed market in the EU and a guaranteed price for specific quantities of sugar, just as the CSA had provided the Commonwealth sugar suppliers with a guaranteed market and a guaranteed price in the UK for their individual country quotas. In order to ensure that the UK could import the quantities of sugar that were covered by the CSA, the UK government controlled the production of UK sugar and the quantity of other imports. At the time the protocol was negotiated the EU had a sugar quota system which limited the volume of sugar for which EU producers could benefit from price support. Production outside quota had to be exported without export refunds and surplus production of quota sugar was exported with the aid of export refunds which were financed by levies charged on quota production. So all the EU had to do to integrate the imports of ACP sugar that was covered by the protocol into its sugar regime was to add an equivalent volume of sugar to its export programme.

Two main challenges to this stable situation arose. One was a major change in EU trade relations with the ACP. The Lome Convention and its successors were all based on non reciprocal preferences granted by the EU. So far as agricultural products were concerned, these preferences were, generally speaking, only granted on ad valorem tariffs not on the variable levies that protected the EU's main products, with a few exceptions, like the one that applied to sugar, where the ACP were granted completely duty free access but for a limited volume. This situation came under both intellectual and legal attack. The intellectual attack was that its result, naturally enough, was that the only agricultural preferences that were used to any great degree by the ACP

were the “high value” volume limited preferences, in particular those on sugar, bananas and beef. This distorted (or so the argument went) ACP production and did nothing to integrate ACP countries into the world market or even to develop their trade relations with neighbouring ACP countries. The legal attack came from a number of GATT and WTO cases that were brought against the EU regime for bananas, an early one of which established that the Lome Agreements could not be regarded as Free Trade Agreements, so the preferences granted under it breached Article I of GATT, which requires equal tariff treatment to be granted to all members, with an exception to permit the creation of Free Trade Areas or Customs Unions.

The result of all this was the development of the policy of replacing the non reciprocal preferences with GATT compatible Free Trade Agreements which would form part of Economic Partnership Agreements, EPAs between the EU and the various regional groupings of ACP countries. -This policy was agreed between the EU and the ACP in the first Cotonou Agreement. Whilst this policy was being developed and brought to fruition, the EU, with ACP support, negotiated waivers from Article I of GATT, the last of which expired at the end of 2007. From then on the EU gave duty free access to those ACP countries who had negotiated EPAs or interim EPAs. Within the EPAs there were some transitional volume restrictions (set at what proved to be non restrictive levels) on sugar but there were no longer any country specific tariff quotas. This was incompatible with the Sugar Protocol and the EU therefore gave the required two year notice to terminate and it ended in 2009.

The other major challenge arose from WTO Dispute Settlement cases against the EU’s interpretation of its Uruguay Round commitments on sugar brought by Brazil, Australia and Thailand. The findings in these cases were that the footnote in the EU’s export subsidy commitment on sugar that the EU thought entitled it not to count the so called re exports of ACP sugar against the limit on its subsidised exports was invalid and also that exports of non quota sugar had also to be counted against that limit. This was because, although no export refunds were paid on this sugar, it was held to benefit from cross subsidization from quota sugar. This, and the unlimited duty free quota free access that the EU had promised would be granted to Least Developed countries, formed the backdrop to a radical reform of the EU sugar regime in 2007. Under this reform, support prices were cut by 36%, and restructuring aid was granted to those sugar firms who were prepared to surrender their quotas. The aim was to produce a smaller but more competitive EU sugar industry and to arrive at market balance taking into account the newly defined limit on subsidised exports and the expected volume of imports from preferential suppliers, including the ACP. It’s effect was to turn the EU from being a net exporter into a net importer. Under the new quota system, out of quota production was now permitted to be sold on the EU market for non food purposes. It could also still to be exported without refunds but these exports were now limited to the reduced volume permitted by the WTO. To leave as much room as possible for out of quota exports, the EU ceased to pay export refunds on quota sugar - and therefore also on the sugar content of exports of manufactured foods.

In setting its own sugar production quotas at a level that left room for preferential imports the EU was -no doubt unconsciously - imitating what the UK had done in the past with regard to CSA supplies - and with a curiously similar result. In the last period of the CSA, world prices rose to very high levels and some CSA suppliers defaulted on their supply commitments. By that time the UK had joined the EU but had not yet integrated its sugar policy into that of the EU, because

it had first to fulfil its obligations in the last CSA quota period, which ran until 1975, so the supply default created a market shortage. After the price and quota cuts resulting from the 2007 EU Sugar Reform came into effect, ACP and Least Developed country supplies to the EU fell short of what the EU had expected and at the same time world sugar prices rose above EU support prices levels. The EU met this situation by opening up additional tariff quotas and by, as an exceptional measure, permitting some non quota sugar to be sold on the EU market. But, of course, for imports to take place, the EU market had to rise along with the world price.

From the very beginning of the EU's sugar regime back in 1968 its quota provisions had always been for time limited periods. Initially this was because quotas were regarded as a temporary derogation from normal market principles but, in time, they came to be seen as a cost effective way of providing market stability. So the end of each quota period was seen as an opportunity to review the rules and sometime the distribution of quotas but not to question the continuance of the quota system itself. When, however, the Commission came to review CAP policy in connection with the setting of the EU financial perspectives to 2020, this presumption that the quota system was inviolable came under question. The general thrust of CAP reform in recent years has been to move to more "market orientation" and to get rid of production restrictions in all their forms. At the same time, EU trade policy, particularly in the light of the deadlock in the Doha Round of Trade negotiations - has been to expand its network of Free Trade Agreements. To be compatible with WTO rules, these have to cover "substantially all trade" which means that in many cases they must involve sugar. This poses a challenge to a quota system that supports prices by controlling the volume of sugar coming onto the market. And EU food exports have become increasingly based on value added processed products, not primary commodities. This has increased the influence of the Food Manufacturers, who have always criticised the sugar quota regime and whose complaints have become more vociferous since they have ceased to be compensated for normally the higher cost of EU sugar. So perhaps it was not surprising that when the Commission published a Communication at the end of 2010 on their thoughts on the content of the next CAP reform, they said that among the options it was considering was a non disruptive end to the sugar quota regime. What came as a real surprise, however, was that when the Commission published their legislative proposals the following year, these simply noted that the quota regime expired in 2015 and made no provision for phasing it out.

This has come as a great shock to EU sugar beet producers and sugar manufactures, because it menaces the market stability that the quota regime has traditionally provided and also, of course, to the ACP, because it means that for the first time their supplies will be in open competition with EU supplies - a sharp contrast to the situation that has applied to developing country Commonwealth sugar suppliers ever since the entry into force of the CSA back in 1951.

So, when will a legislative decision be taken, will the proposal pass and, if it does, what will be the effect on sugar trade between the ACP and the EU? Three simple questions but I am afraid that there are no simple answers. Here are the complicated answers.

When will the legislative decision be taken? The CAP reform proposals, including the one on sugar, have been made in conjunction with proposals for the next Multi-Annual Financial Framework (MFF), which covers the period from 2104 to 2020, and they cannot be adopted before the MFF itself . This framework will set limits to the maximum size of the EU Budget in

each of these years and therefore will act as a constraint on all EU policies that have budgetary implications. Decisions on Commission proposals for the MFF are taken by unanimity in the Council with the consent of Parliament. The provision for budget commitments proposed by the Commission amounts to 1.05% of EU GNP. This amount has neatly split the Council into two groups - the net contributors to the budget, who say that this is too much and the net recipients, who say it is too little. Both sides agree that the negotiations should be concluded by the end of this year – but neither has given any indication of a readiness to compromise in order to meet this deadline so confidence that it will be respected is not high..

Despite this, the agricultural negotiations are being scheduled in a way that would, if there is indeed an agreement on the MFF by the end of this year, enable the CAP reform proposals to be adopted in 2013 and come into force in 2014. The legal process for adopting the CAP reform proposals is somewhat different from those that apply to the proposals on the MFF. Thanks to the entry into force of the Lisbon Treaty, CAP reform will be decided by a process in which Council and Parliament will be equal participants. The process is that Commission proposals are submitted at the same time to Council and to Parliament and both examine them and informally exchange views with each other. Then the first formal step is taken by the Parliament, which votes by simple majority on its first reading position, which normally takes the form of proposed amendments to the Commission proposal. The Council can then adopt the proposal if it is ready to accept all the Parliament's amendments. If not, then it returns the proposal to the Parliament with its own amendments. The Parliament then votes on the Council's proposal. If it votes in favour, then the proposal is adopted as amended. If it votes against, the proposal falls. If it proposes amendments to the Council's position, the proposal as amended go back again to the Council. If the Council agrees with this second proposal by the Parliament, the proposal is adopted. If it does not, then a conciliation committee consisting of representatives of the Council and the Parliament is called to try to find a compromise, which is then submitted to Council and Parliament for approval. If it fails to to find a compromise, or if Council or Parliament rejects the compromise, the proposal falls. There are no time limits on the adoption by Parliament and then by the Council of their positions on first reading but if a proposal is not accepted on first reading, then there are deadlines attached to all subsequent stages of the process.

Will the current proposal pass? Council and Parliament are conducting their first discussion on the Commission proposals. In the Parliament, what this means is that the proposals are under examination in the Agriculture Committee. The Agriculture Committee will submit draft amendments to the plenary of the Parliament for adoption as its first reading position. In the Council several – but not all – members have indicated that they believe that the sugar quota scheme should be extended beyond 2015. In the Agriculture Committee of the Parliament, the rapporteur, whose task is to propose a text for to be voted in the Committee as a whole, has prepared draft amendments which, broadly speaking, would reinstate the current quota provisions for the further 5 years until 2020. This follows representations from the EU sugar beet growers and sugar manufacturers who argued that they need extra time in which to prepare for a more competitive environment. Both, however, appear to accept that the quota scheme should end in 2020.

In short, there are some indications that the Commission proposal to end the regime abruptly in 2015 may be amended but we are at a very early stage in the negotiations and no one can foresee

what the final decision will be or indeed precisely when it will be taken. One could imagine the situation as a three horse race, with one horse called "quotas to end in 2015", one called "quotas to end in 2020" and one called "quotas end at some compromise date between 2015 and 2020". The ACP representatives in Brussels tried hard to persuade the Development Committee of the Parliament, which has been assigned a subordinate role in the process, to enter a fourth horse "extend to 2020 without prejudice to what happens after then" but they did not succeed. My feeling is that currently the shortest odds are on the horse called "end at some compromise date between 2015 and 2020"– but at the moment the horses are still being paraded in the paddock and the odds can change before the starting signal is given.

What would be the effect ending the EU quota scheme on ACP sugar exports to the EU? There are a few key facts to keep in mind. First, EU sugar production is regularly well above the total of EU quotas. In the latest year for which final figures are available, 2010/2011, it amounted to 15.4 million tonnes and the forecast for the current year is 18.6 million tonnes. The total quota, i.e. the maximum that can normally be sold on the food market, is 13.34 million tonnes. So, assuming no change in production, the end of the quota scheme will mean a lot more EU sugar will be eligible to be sold on the EU market for food. But if all this sugar is released onto this market, prices will fall and production in the parts of the EU where it is least attractive will eventually fall too. So, although producers in the areas where sugar production is most attractive will probably be maintained or even increased, this will be partially offset be reductions elsewhere. Second, the EU will probably still import some sugar under some of its various preferential import arrangements. In addition to the duty free access available under the EPAs and the LDC scheme, the EU has granted tariff free quotas to the Western Balkan countries and reduced tariff trqs to Brazil, Cuba and Australia. It is in the final stages of ratifying agreements with the Central American countries and with Columbia and Peru that also include tariff free trqs. For such imports to take place, internal EU prices, in the deficit areas where such imports are likely to take place, will have to be above world prices. This will mean that the link between EU prices and the world price that has already become evident in the years since the EU became a net importer is likely to continue. So, the higher the world price, the higher the price in the EU. And the higher the EU price, the higher will be EU production. And the higher EU production, the less space there will be for imports.

All this is, relatively speaking, straightforward and relatively obvious. Where things get tricky is when one tries to put numbers into these general points. Together with their proposals for the CAP to 2020 the Commission published an impact assessment, which included an annex on the impact of the ending sugar quotas. This made predictions on the basis of two world price hypotheses, the higher one of which was derived from the latest available forecast at that time made by OECD/FAO and was 313 euro/tonne. The lower price hypothesis was of a world price of 250 euro/tonne but we can ignore this, as it is far below more recent world sugar price predictions. On the basis of a world price of 313 euro/tonne they forecast an increase in the EU sugar beet area in 2020/21, compared their forecast if quotas are maintained , of 1.9%%, a 3.5% reduction in white sugar prices and a 8.2% reduction in sugar beet prices. Imports of sugar from the ACP and LDCs would be 2.5 million tonnes, a little less than they would be if quotas were maintained – but still well above the figure of about 2.2 million (presumably tel quel) they showed in the base year of 2009/2010. This relatively benign outcome was largely due to the fact that they forecast a big increase in EU beet production being used for bioethanol.

The Commission's impact assessment was widely criticised, in particular for over optimism with regard to bioethanol, for not dealing adequately with isoglucose, whose quotas will also end when the sugar quotas end, and for not taking into account the tariff quotas that will be granted to the Central Americans, Peru and Columbia if the Agreements that have been negotiated with them are approved by Parliament. These agreements include duty free trqs for sugar totalling 246,000 tonnes (raw equivalent) of sugar and a further 30,000 tonnes of high sugar content products. Also, it assumed the ending of quotas would take place one year later than in the Commission proposal itself. Furthermore, the OECD/FAO world price forecasts have been revised upwards since the one that was available to the Commission when it made its impact assessment. The Commission have, therefore been making a revised assessment. Its results have not yet been published but are expected to show more sugar production, less ethanol production, more isoglucose production and hence less sugar consumption and as a result of all this, fewer imports.

Another forecast was made last year by a group of econometricians headed by Stephan Nolte of Ghent University. This was much less reassuring than the one made by the Commission in their original impact assessment. In part this is because it was made later than the Commission's impact assessment and therefore after the OECD/FAO had revised upwards their previous world price forecasts. Nolte used three world price hypotheses, the central one being 356 Euro/tonne. On this basis he predicted extra EU supplies on the EU market would squeeze out all LDC imports and reduce ACP non LDC imports to 0.34 million tonnes. The effect would be less drastic on a lower world price hypothesis of 290 euro/tonne. Although LDC imports would still drop to zero, ACP non LDC imports would be 1.24 million tonnes. But on a higher world price assumption of 416 euro/tonne both ACP and LDC imports would be eliminated. If there is any crumb of comfort in Nolte's predictions, it is that part of the reason that he forecast the elimination of ACP imports from the EU if world prices are high is that in that situation the world market or ACP local markets would become more attractive to ACP exporters.

Without delving deeply into the differences in the econometric models used by the Commission and Nolte, an important difference between the two studies is that Nolte said nothing about bioethanol, which the Commission assumed will expand considerably and take a lot of the pressure off the sugar market. Nolte did not examine isoglucose in any detail. He simply said that there were a wide variety of possible outcomes, ranging from its complete elimination to a substantial increase in its current 4% share of the EU market. An expansion of isoglucose, were to happen, would, of course, put further pressure on sugar producers in the EU and on the EU's preferential suppliers, including the ACP.

Are there any sparks of light in this gloom? Well, first, as I have already said, the lowest forecasts of EU imports of sugar from the ACP are made on the highest world price assumptions. But if world prices are going to continue to be high, then the prospects for trade elsewhere, and in particular with other members of the regional ACP groupings, will be good. Second, we should not forget one of the intellectual reflections that lay behind the policy of replacing the Lome system of unilateral but limited preferences with the tariff-free quota-free policy of the EPAs. One of the objects of the EPAs is to encourage ACP production and trade to develop on the basis of comparative advantage rather than on the basis of a few products for which there were a very

high effective preference for a volume limited quantity. So long as the ACP retain duty free access to the EU market, the end of quota restraint on EU sugar production should not necessarily mean the end of the sugar trade between the ACP and the EU, at least as regards those ACP countries that do have comparative advantage in sugar i.e. those for whom sugar is what they can produce at least cost compared to other products. When the sugar industry was developed here in Fiji in the 19th Century it was, I assume, based on the belief that this was the best kind of production for Fiji to be in. If this was right then and is still right today, then sugar should continue to be a major component of the Fijian economy and Fijian exports and the same will be true of many of the other ACP sugar producers.

Time to summarise what I have said..

What I tried to show from a historical perspective is that the sugar trade relationship between the Commonwealth ACP countries and Europe has developed in an evolutionary rather than a revolutionary way over the last 60 years. But scientists tell us that, in the development of species of living things, evolution, even though it proceeds by tiny steps at the genetic level, can produce a sudden step change in the species itself. The end of the Sugar Protocol in 2009 coupled with the end of the EU sugar quota system seems to me be likely to produce a step change, this time not in the development of a species, but the development of a trading relationship.

I then attempted to sketch out the complex legislative process that is now underway on a major package of legislation in which the future of the sugar regime is but one component. I said that the hope was that the legislative decision would be taken in 2013 and that the CAP reform regulations could enter into force in 2014. This process is still at an early stage but there are some signs that CAP market regime regulation might possibly include a extension of the sugar quota regime for a few years – but not forever and probably not for very long.

Finally I described two forecasts of ACP exports to Europe in a future where they are no longer protected by the guarantees that in the past were given by the CSA and then by the Lome Sugar Protocol and where the EU production quotas will no longer be there so that the market rather than EU policy will decide whether there will be any space on the EU market for imports.