

The Byzantine EU Sugar Regime

Wealthy EU producers supported by consumers and developing countries

The sugar policy of the European Union is one of the most distortionary agricultural policies in the world. It combines restrictions on imports of sugar from third countries with price guarantees for sugar produced for domestic consumption within the EU. The price to consumers is guided by an institutionally determined intervention price that has been 2-3 times above the world market price for a number of years. The policy distorts not only the allocation of sugar production within the European Union but also the volume of world trade and it depresses the production of sugar in a number of developing countries.

Against this backdrop the EU is under pressure to reform its sugar regime. Following the Uruguay Round Agreement on Agriculture (URAA), the EU is required to reduce its border protection and to limit the quantity of subsidised sugar export. In addition, the prospective enlargements of the EU will greatly increase the potentials for surplus production of sugar in the EU, and make it difficult to comply with the commitments of the URAA. Finally, the agricultural negotiations under the auspice of the WTO will probably lead to an increased pressure for limiting the use of export subsidies and increasing market access in general.

In an attempt to tackle these problems, the European Commission is heading for a major revision of the sugar regime. Two strategies could be followed, namely quota and price cuts. The study published by the Danish Research Institute of Food Economics (Frandsen, Jensen, Yu and Walter-Jørgensen, 2001) analyse these two options. It is demonstrated that a price cut strategy is a far more efficient instrument to achieve the overall objectives of a reform than a reduction of quotas having little impact on the total production of sugar in the EU. It is also found that reducing prices in the EU will enhance production considerably in several developing countries.

THE EU SUGAR REGIME

In the EU the production of sugar is regulated through the use of so-called A- and B-quotas for sugar beet, producers of which receive the intervention price net of producer taxes. The producer taxes cover the cost of bridging the gap between the internal price and the world market price for exports of B-sugar, making the scheme self financing. Production in excess of the A- and B-quotas is sold on the world market without any support from the EU (so-called C-sugar). The costs of re-exporting mainly raw sugar imported on preferential terms from ACP (African, Caribbean and Pacific) countries and India, which has been refined within the EU, are, however, covered by the EU budget.

Although producers of sugar beet receive just the world market price for their exports of C-sugar, the use of A- and B-quotas provides an incentive for expanding production beyond domestic consumption (i.e. cross subsidisation). This tendency is further strengthened by the fact that producers actually plan on excess production of sugar beet so as to be able to fulfil the contractual agreements for deliveries to sugar refineries. The costs of the sugar scheme are therefore shared between con-

sumers in the EU, who pay a high price for the product, and producers in countries outside the EU, who face lower world market prices due to the subsidised exports of sugar from the EU.

POSSIBLE REFORM SCENARIOS

A possible reform of the sugar regime could entail the elimination of the current practise of cross-subsidisation of exports of B-sugar. The EU is one of the largest exporters of sugar in the world. Between 30 and 40 per cent of EU sugar production is exported to third countries, 60 per cent of the exports being B-sugar. This leaves the EU with mainly two strategies: a reduction in a) quotas or b) intervention prices. The findings of the analysis illustrate that both options would impact significantly on the regional distribution of sugar production within the EU. The study also demonstrates that the impacts of the two options would have very different effects on the level of border protection and the degree of market access, thereby having significantly different consequences for countries outside Europe.

EUROPEAN RESULTS

Eliminating exports of B-sugar by reducing the sugar quota would have only a limited impact on the total output of sugar in the EU (it will fall by only 1 per cent) as the production of C sugar being exported at the world market price would increase while the production of A and B sugar would fall in some countries and increase in others. This supply behaviour is a direct result of the self-financing scheme that reduces the need for producer taxes when exports of B-sugar are reduced or eliminated. Lower taxes will lead to higher prices provided to producers of A- and B-sugar beet, making it profitable to expand production within the established quota limits. Due to differences in production costs, the supply response will differ across the individual countries in the European Union.

Production will decline in Denmark and Belgium being neither low nor particularly high-cost sugar beet producers, whereas the production in high-cost countries (such as Greece, Portugal, Italy and Finland) will increase. Production in low-cost countries such as France and Germany will remain unchanged. The ultimate effect of a quota reduction would therefore be a more inefficient distribution of the sugar production within the EU. Competitiveness of European sugar production on world markets deteriorates as a result. Elimination of exports of B-sugar through a reduction of quotas will have virtually no impact on production and trade in the developing countries.

If instead the export of B-sugar is eliminated through reductions in the guaranteed prices of sugar beet, this will have a significant effect on the production of sugar in the EU. According to the analysis, a 25 per cent reduction in border protection will reduce the overall production of sugar by nearly 19 per cent, consumption will increase, and the production of A- and B-sugar will no longer cover the European domestic

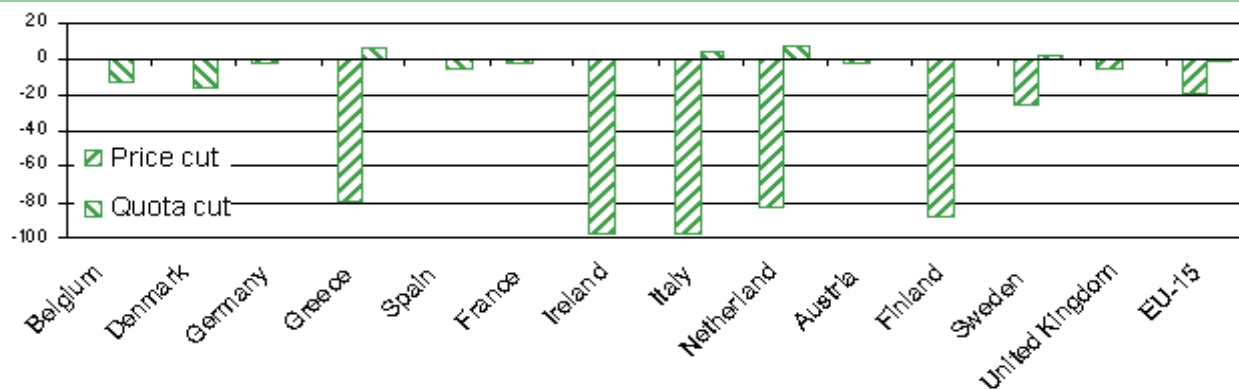
RESEARCH PROJECT MISSION

This research project analyses the economic consequences for developing countries of changes in agricultural and trade policies in relation to the WTO negotiations.

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FIGURE 1. CHANGE IN EU SUGAR PRODUCTION, PER CENT.



demand for sugar. The EU would still, however, be exporting C-sugar to the world market.

Production would fall most in high-cost areas notably in Greece, Finland and Italy, where production of sugar beet would more or less cease. Production would also be reduced in Ireland, the Netherlands and Sweden, whereas Belgium and Denmark would maintain their present levels of production. The latter is explained by a buffer effect of the quota rents. The production of sugar beet in France, Germany, Austria and United Kingdom, being determined at the margin by the world market price, is not affected by the reduction of the guaranteed prices in the EU. The impact on European production of sugar in the two scenarios is illustrated in figure 1.

IMPACTS ON THIRD COUNTRIES

The lower import tariffs and a lower level of production of sugar within the European Union leads to a significant increase in trade with third countries in the price reduction scenario. EU reduces its exports of sugar and increases imports, most notably from Brazil, USA, India, South East Asia and the Caribbean (Cuba & El Salvador). Also ACP-countries such as Malawi, Tanzania, Zambia and South Africa, that have specific trade agreements with the EU, would benefit in terms of increased exports to the EU market. World trade in sugar increases by more than 10 per cent due to a 2 billion US\$ reduction in EU net exports. The impacts on the developing countries in the two scenarios are illustrated in table 1. Clearly in the quota cut scenario the positive impact on the developing countries is absent. In contrast, significant positive effects can be expected following a serious price reform of the EU sugar policy in terms of higher export prices and domestic sugar production in a number of countries outside Europe.

The price scenario illustrates another important aspect of the European sugar policy and the impacts on developing countries of having preferential access to the European sugar market: A full or partial liberalisation of the European sugar regime would reduce the economic value of having preferential access to the European market. The EU imports of sugar from the ACP-countries and India are regulated through a Tariff Rate Quota (TRQ) system that allows these countries to export sugar to the EU on preferential terms.

The effect of lowering the out-of-quota tariff rate will, however, depend on who benefits from the TRQ-system. If the

producers in developing countries are the beneficiaries (receiving the quota rent), they may find themselves in a weaker competitive position relative to other exporters to the EU, if barriers at the EU border are lower. Assuming that the quota rent accrues to the governments of developing countries, it is found that the ACP-countries and India would lose the existing quota rent, or part of it, as a result of the price reductions in the EU. This loss is, however, balanced by increased production and exports of sugar, leaving the economies as a whole unaffected.

CONCLUSION

An EU sugar policy reform with only limited reductions in the sugar production quotas or even cuts that eliminated the export of B sugar will not increase domestic efficiency within the European Community. Furthermore, it will not alleviate the problems of the developing countries since neither market access nor net-exports from the EU will be significantly affected.

A serious sugar reform would therefore have to involve the lowering of the guaranteed prices provided to producers of sugar in the EU. A reduction of prices will have an immediate impact on production and will reduce the cross-subsidisation of exports of sugar to the benefit of a number of developing countries through improved market access and less unfair competition from subsidised exports. Moreover, efficiency gains within the EU will be achieved, as the production of sugar will be concentrated in low-cost areas making the industry more fit for competition in international markets.

A possible political downside of such price reductions is that it might remove the economic basis for production of sugar in high cost areas of the EU. Such costs should of course be weighted against the economic gains in both a number of developing countries as well as in the Community at large and the possible political gains in terms of a higher degree of flexibility related to the enlargement process and the WTO negotiations.

Finally, the current granting of preferential access to the EU market to selected developing countries is an inefficient instrument for supporting the economies of developing countries. The system is administratively burdensome, there is uncertainty as to who gets the benefits (quota rents), and it would generally serve the developing countries better to have free access for their products to the markets of developed countries.

TABLE 1. IMPACT ON SELECTED THIRD COUNTRIES, PER CENT.

	Scenario 1			Scenario 2		
	Export prices	Production	Quota Rents	Export prices	Production	Quota Rents
Brazil	0.3	3.9	-40	0.0	0.2	0
Central America and Caribbean	0.5	7.2	-	0.0	0.6	-
India	0.0	1.7	-43	0.0	0.0	0
Malawi	0.5	20.3	-	0.0	1.0	-
Other South African countries	-	24.5	-	-	0.3	-
Rest of South Asia	0.2	6.6	-	0.0	0.0	-
Tanzania	0.1	48.5	-43	0.0	0.8	0
Zambia	0.9	7.4	-42	0.0	0.2	0
Zimbabwe	0.5	4.0	-46	0.0	0.3	0

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