

### Everything But Arms (EBA) and the EU-sugar market reform - development gift or Trojan Horse?

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Deutsches Institut für  
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Everything But Arms (EBA) and the EU-Sugar  
Market Reform – Development Gift or Trojan  
Horse?

Michael Brüntrup

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## Abbreviations

ACP	African, Caribbean and Pacific (countries)
CAP	Common agricultural policy
CGE	Computable General Equilibrium
CIUS	Committee of Industrial Users of Sugar
CTA	Technical Centre for Agricultural and Rural Cooperation
DG	Directorate General
EBA	Everything But Arms
EU	European Union
GDP	Gross domestic product
GTAP	Global Trade Analysis Project
IMF	International Monetary Fund
IRR	Internal rate of return
LDCs	Least developed countries
LMC	Lower Middle Income Country
NGO	Non-governmental Organization
ODA	Official Development Assistance
SADC	Southern African Development Community
SMO	Sugar Market Order
SPS	Special Preferential Sugar
UK	United Kingdom
US \$	United States Dollar
WTO	World Trade Organization

## 1 Introduction

The EBA-Initiative of 2001 has made three notable exceptions to its commitment for tariff and quota free access of least developed countries (LDCs) to the EU-market: Sugar, bananas, and rice, for which longer transition periods have been imposed.

Despite the decelerated opening of the EU market for EBA sugar, it is precisely sugar that presently constitutes the highest preferential value for LDCs, at least in the short and medium term and given the present high EU sugar price of more than 600 Euros per ton under the current Sugar Market Order (SMO), which is more than triple the world market price. The EU itself projected that the EBA exports would attain 3.3 million tons per year in 2013 at a value of almost 2 billion Euros.

However, in June 2005, the EU proposed a reform of the EU sugar market with a substantial reduction of the sugar price of about 40 %. For the EBA countries it was calculated that by 2013 exports will fall to 2.2 million tons and export receipts by about 1 billion Euros relative to the unchanged SMO. The final reform has reduced the price drop slightly to now 36 %. Certainly, all actors who profited in the past from the high sugar prices will loose, but whereas EU producers (and to a lower extent older African, Caribbean and Pacific (ACP) preferential exporters) will receive high cash compensations for losses, EBA countries are not considered since their very high losses are “only” computational against the high expected future exports. Albeit, they are the most vulnerable and needy of all losers. Thereby, the EBA initiative will partially loose its economically most important impact.

Analysing this succession and economic outcome, there are strong arguments to support the belief that the high motivation for the inclusion (and longer term transition) of sugar in the EBA initiative was to destabilise the old sugar market system. Without the EBA initiative, a strengthened quota management system would have made the system survive with its extremely high prices, although with major difficulties in balancing the interest of different countries and their sugar sub-sectors and at the expense of continuing lack of European sugar production competitiveness. Thus, the EBA sugar imports constituted a “Trojan Horse” to the EU SMO which made a price cut almost inevitable. This is not to argue against the price reform which was necessary in sight of the highly distorted and costly EU sugar sector, but to hint to a highly unfortunate economic and political signal towards LDCs.

The remaining of the paper is structured as follows: Chapter 2 briefly shows that sugar is a key to the EBA initiative from the European side, but also for many developing countries. Chapter 3 assesses likely impacts of the EBA initiative on (sugar producing and exporting) LDCs at the time of its implementation, e.g. without reform of the European SMO. Chapter 4 describes the setting that pressed for the reform of the sugar market, and the major options available. In Chapter 5 the reform, as it was finally decided, is briefly presented, and the role that EBA played in shaping this outcome. Chapter 6 discusses the changes of impact of EBA relative to the unreformed SMO scenario.

Chapter 7 concludes that the EU commission has used EBA to bring forward a reform in the sugar sector in the spirit of the common agricultural policy (CAP) reforms – alignment with world market prices and decoupled direct payments – and has set the scene for fur-

ther reforms by breaking up the big sugar alliance. For LDCs, the European sugar market is still attractive due to its high and stable prices and long term perspective until 2015, but the export profits (the rents) and thereby the likely investments are clearly reduced. It is warned that if there are no “compensations” for the imputed profit losses to EBA countries, this genial political deal would leave a “bad taste” of EBA, tariff preferences and the development orientation of the EU in reforming its trade and agricultural policies. This could have negative repercussions for the overall world-wide liberalisation process, making a precedent case that liberalisation negatively affects particularly the poorest countries.

## 2 The EU sugar market order – a highly sensitive issue

When in 2000 the EBA-initiative was announced, a storm of protest went through parts of the agricultural sector in Europe. According to Oxfam (2000, 1), the protests were “*launched by the National Farmers’ Union and parts of the multinational sugar industry, labelling it a threat to UK sugar beet growers*”. Background is the highly protected nature of the EU sugar market (see Box 1).

### Box 1: Essential features of the actual European sugar market organization

- An intervention price is used to determine the minimum price that triggers official sugar purchases. This intervention price in turn is used as a basis to set prices at various processing stages.
- Specific tariffs of, at present, over 400 Euros per ton of white sugar (roughly 320 Euros for raw sugar), a figure amounting to 130–260 % of the world market price (which has in recent years ranged between 160–300 US \$ per ton), and the permanent use of special agricultural safeguard measures total to a protection of more than 700 Euros per ton which have until now served to shield the market against any non-preferential imports.
- To contain overproduction, quantitative target output quotas are set and allocated to the member countries. A distinction is made between regular A-quota sugar and B-quota sugar, which is roughly 40 % cheaper.
- Surpluses (so-called C-sugar) are sold on the world market, i.e. exported in the form of sugar and sugar products manufactured by the sugar-processing industry. In addition, all preferential sugar imports are re-exported. Part of these transactions profit explicitly from official export subsidies (in particular the re-export of preferential imports from ACP countries (compare Box 1) at a cost of 0.8 to 2 billion Euros per year in the last decade, depending on the EU-world market price gap and excess sugar in the EU), another part benefits implicitly from high administrative prices, with mandatory charges levied on the sugar industry (finally the consumer) used to finance exports.

But also other groups joined the afore-mentioned protest against including sugar into the EBA initiative, particularly sugar exporting ACP countries that had preferential access to the EU (compare Box 2). These sugar protocol ACP countries tried to ensure that EBA-sugar would not undermine their interests (ACP-EU 2001). Only three of these countries are LDC, namely Tanzania, Madagascar and Malawi.

Other but less fervent concerns were raised against rice and banana liberalisation. The protests led to three seemingly minor but in reality important exceptions from full liberalisation in EBA for three sensitive products – bananas, rice and sugar. By introducing long

transition schemes, the most interesting elements of EBA for the LDCs were delayed for many years.<sup>1</sup>

**Box 2: Preferential access to the EU sugar market for ACP countries**

- Under the sugar protocol, a present total of 20 African, Caribbean, and Pacific (ACP) countries enjoy irrevocable duty-free import quotas amounting to a total of roughly 1.3 million tons of white-sugar equivalents per year. Mauritius alone accounts for 38 % of this quota, and Fiji, Guyana, Jamaica, and Swaziland together account for another 43 %. For India there is a similar arrangement in place for 10,000 tons.
- The Special Preferential Sugar (SPS) arrangement is a non-binding EU commitment that allows further duty-free exports of raw sugar to cover the specific needs of certain sugar refineries. In recent years this has meant a volume of some 150,000–300,000 t/year. The beneficiaries of this agreement too are mainly the ACP countries and India.

The then trade commissioner Lamy conceded in an interview in 2001 that the three sensitive products represented 40 % of the newly liberalised exports of LDCs into the EU, whereas the non-sensitive products represented 60 % (EU 2001). In an early computational experiment using a world wide computable general equilibrium model, Cernat et al. (2003) found that without quantitative import restrictions, “in value terms, looking at the aggregate exports of LDCs, the increase associated with EBA is very concentrated in sugar and sugarcane, which account by themselves for almost all the changes in values”. After some years of implementation, sugar is still clearly dominating the impact of the EBA initiative.<sup>2</sup>

In the case of sugar, up to July 1, 2009, when market access to the EU will be entirely free, EBA countries are allocated sugar import quotas (for raw sugar only). Quotas started from existing imports of 74,000 tons in 2001/02, with the quota then rising by 15 % per year up to 197,335 tons in 2008. The quota allocation to different countries and producers is managed by the European Commission via a complicated (and non-transparent) system of quota application by and approval of the LDCs’ sugar group (Garside et al. 2005).<sup>3</sup> Parallely, starting in 2006 non-quota tariffs are set to be reduced to zero in three stages of 20 %, 50 % and 80 %.

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1 It should be noted however, that presently sugar is only of minor importance for LDCs’ exports as a whole: 535,000 tons of raw and white sugar or 1.1 % of all LDCs’ agricultural exports of 5.8 billion US \$ in 1998, giving it rank 15 at the HS6 level (if including molasses, 1.3 % and rank 10 at the HS2 level, Höllinger / Hauser 2002). This puts the EBA initiative into perspective: many export products of LDCs such as crude oil, diamonds, minerals and many tropical products face already low or zero tariff either on a MFN basis or under general preferential tariff schemes. Other products with high tariff barriers being liberalised in EBA are either not produced in tropical LDCs or face high non-tariff barriers.

2 Compare the Matthews / Bureau chapter in this book.

3 The intransparency and complicated nature of the EU sugar import regime management is worth noting because it leads to serious misinterpretations of impacts. For instance, Cernat et al. (2003) state that Mozambique, since it did not export any sugar to the EU prior to EBA on which to calculate the 15 % annual increase, “will be unable to export any cane sugar until 2009”. In contrast, actually Mozambique had a quota allocation of 8,331 tons in 2001/02 (LMC International 2004).

### 3 Sugar in the EBA-Initiative – probably the main “development gift” for LDCs

While for the time being sugar exports from LDCs are still being substantially hindered by quota, future years could see a substantial raise. The size of the sugar export surge will determine the value of the entire EBA initiative to a large degree. The direct impact of EBA on sugar sectors of LDCs depends mainly on their own sugar production and exports, and the internal distribution of revenues. Effects on the world market price through LDC exports not directed to the EU and through LDC imports are less important due to the small amounts affected and the similar reduction of exports and export subsidies in all EU alternative scenarios (see Chapter 4). A possible additional impact of the SMO reform, its signal for reform of the sugar policies in LDCs, will be briefly discussed.

LDC are not homogeneous with regard to sugar production and consumption. “*As a whole, the LDCs have a net deficit approaching one million tonnes per annum*” (LMC International 2004, 7). The production of sugar is concentrated on some 22 LDCs which have formed the LDCs’ sugar group<sup>4</sup>. In several other countries sugar mills are no longer operational but a production potential probably exists (LMC International 2004).

There are at present six net exporting LDCs (Ethiopia, Malawi, Myanmar, Sudan, Zambia and Angola) and two which are in a process of rehabilitation and close to becoming net exporters (Mozambique and Tanzania). Only Malawi and Tanzania export refined sugar, the others raw sugar only. As mentioned, three LDCs have already preferential though quota-restricted market access to the EU under the ACP Sugar Protocol – Malawi 21,000 tons, Madagascar: 11,000 tons, Tanzania: 10,000 tons<sup>5</sup>.

In recent years there has been considerable privatisation and rehabilitation in several sugar producing LDCs, most often under foreign investors (LMC International 2004; Garside et al. 2005). These direct foreign investments are key to assessing the impact of EBA, since in LDCs very often neither liquidity nor know-how nor management capacities are sufficiently available. Foreign investors are attracted by preferential agreements offering export rents, but will also consider overall economic policies such as foreign exchange and money transfer and country risks. All this has consequences for supply capacity and supply response. Thus, foreign investment climate, production efficiency and export performance, comparative advantage and (preferential) trade regimes are inextricably linked.

The sugar price which LDC producers can expect when exporting to the EU under EBA depends on the European SMO. When the EBA initiative was implemented in February 2001, a EU SMO was valid as described in Box 2, with a very high reference price of 632 Euros per ton for white sugar, and derived prices for raw sugar and beets according to standard transformation, processing and handling margins. Comparably high prices were paid (but not guaranteed) to ACP sugar protocol country exporters (there are minor adjustments for raw cane

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4 African countries: Burkina Faso, Burundi, Central African Republic, Chad, Democratic Republic of Congo, Ethiopia, Madagascar, Malawi, Mali, Mozambique, Rwanda, Senegal, Sudan, Tanzania, Togo, Uganda, Zambia. Other countries: Bangladesh, Haiti, Laos, Myanmar, Nepal.

5 The signatories of the EU sugar protocol are: Barbados, Belize, Côte-d'Ivoire, Democratic Republic of Congo, Fiji, Guyana, Jamaica, Kenya, Madagascar, Malawi, Mauritius, St. Kitts & Nevis, Suriname, Swaziland, Tanzania, Trinidad and Tobago, Uganda, Zambia, and Zimbabwe.

sugar), and these prices were also granted to LDCs under EBA. Thus, the impacts of EBA on LDCs is discussed here for the old SMO valid at the time of the EBA implementation.

### 3.1 EBA impact on LDC sugar exports to the EU

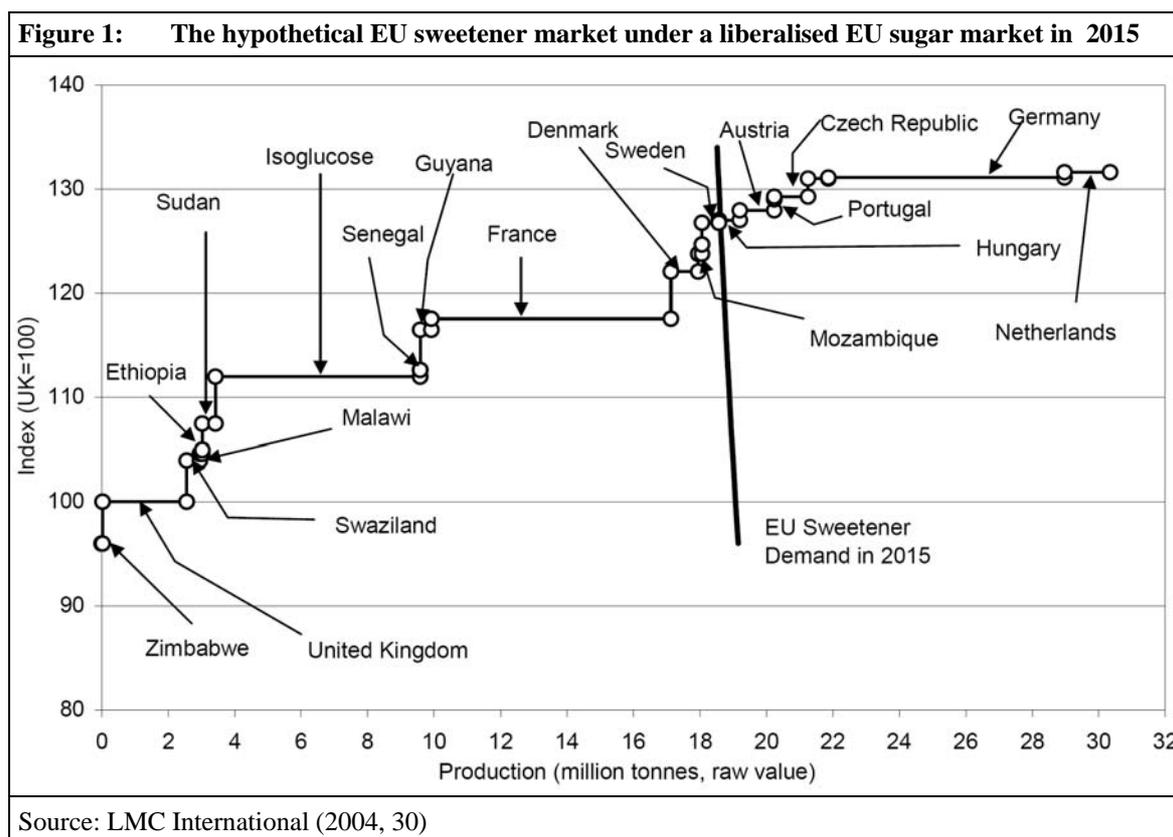
Several attempts have been made to assess the medium and long term investment and supply response to the EBA initiative. Global trade studies including developing countries and sugar markets commonly use the Global Trade Analysis Project (GTAP) data base and model. This global approach, though in principle most appropriate because reflecting interdependencies of markets for capital, production factor and output markets, for the time being is hardly capable of predicting the impact of EBA in combination with EU sugar policy reform without major adaptations since it is based on oversimplified assumptions and weak data. For instance, no individual consideration of most of LDCs which are mostly hidden within the cluster “Rest of Sub Sahara Africa” is made, uniform hypothetical supply elasticities and transportation costs across all countries are assumed and, until version 6 (released 2005), no account for preferences was made (Achterbosch et al. 2004; Huan-Niemi / Kerkelä 2005). In addition, it seems that the restrictive sugar trade policies of the few African LDCs which are explicitly modelled in GTAP are not correctly taken into account (Keck / Piermartini 2005).

In studies trying to at least partially adapt global models to reflect the impact on LDCs of the EU sugar reform under EBA, the exports from LDCs into the EU vary from 0.2 to 2.9 million tons according to various parameters: the degree of price depression, the substitutionability of LDCs and EU sugar, the extent of SWAPs “*importing (cheap) sugar from the world market in order to export more home grown sugar, usually destined to national consumption, at higher price to the EU*” (Berkum van / Roza / van Tongeren 2005). Under the assumptions that that price drops by 33 %, that SWAPs are allowed, that LDC cane sugar is an almost perfect substitute for EU beet sugar if properly refined, and that capital fixed in beet refineries is written off in the medium term in favour of investment in cane refineries (either in the EU or in LDCs), a volume of about 2.7 million tons or 1.6 billion US \$ seems to be the most realistic long-run projection.

Given the limitations of global trade studies to reflect the impact of detailed policy changes, many studies use more detailed partial models of agricultural markets, sometimes including sweeteners and some rudimentary interactions with other markets. For instance, Adenauer et al. (2005) used a regional optimisation model of the European farm sector coupled with a simplified world multimarket model and derived EBA sugar imports under unchanged prices of 3.1 million tons in 2009. However, due to the complex realities of sugar markets – such as conditions of monopsony, imperfect information, production risk and associated quota risks, economies of scale, sunken investment costs, limited tradeability of quotas, rent seeking and political economy, etc. – modelling is difficult and limited by many assumptions. Data availability and reliability are major constraints even under European conditions, much more so for developing countries where market imperfections and complex multi-goal rationalities of farm-household economic behaviours are more accentuated.

One of the most thorough attempts to look deeper into the supply response capacity of LDCs' sugar producers is LMC International (2004) which has attempted to individually model the supply response of 22 EBA countries under certain assumptions of sugar production costs and a minimum expected internal rate of return (IRR) on investment costs which amount to at least 65 % of total production costs (in Europe). This industrial investment approach is probably justified for sugar, certainly more than for other agricultural products, since most of the production is carried out on joint plantations/refineries or under close contract farming schemes. Sugar processing for export is always a large scale industry with its own support infrastructure (electricity, water, quality services etc.). Even medical care and education are provided to secure high labour morale and standards. Therefore, sugar production and processing are rather insulated from the vagaries of fragile LDCs' economic and social framework conditions.

Since the investment conditions in LDCs are still more risky than in industrialised and even "normal" developing countries, the basic required IRR in LMC International (2004) was set at 20 %. The LMC International study then determines the most competitive producers on the EU market, assuming that the EU internally liberalises the sugar market. Under such hypothesis, first LDCs' expected production capacities are calculated, which are then compounded to result in an aggregated supply response curve by combining them with fixed quota productions for EU and ACP countries as well as liberalised isoglucose competition within the EU (Figure 1).



The resulting EU-25 equilibrium price without quotas (but shielded from the world market) is estimated to be about 400 Euros per ton in 2015, a number similar to other studies including the EU (EU 2003) who find 350–450 Euros per ton. At that price, EBA countries would supply about 0.5 million tons raw value. LDCs which are competitive and delivering to the EU include Sudan, Malawi and Mozambique, while others such as Ethiopia

and Senegal would also be competitive but would prefer to sell to other (national and regional) markets with more attractive prices.<sup>6</sup> It is worth noting that most preferential ACP suppliers are not competitive, in particular Mauritius and the Caribbean countries are losers. These results are more or less in line with other study results (EU 2003; Oxfam 2005a).

**Table 1: Projections of the EU on the impact of different sugar reform models**

	Base year	2012/13 Reform	2012/13 No-Reform
<b>PRICES</b>			
Institutional price (€/t)	631.9	385.5	560.0
Cumulative reduction in institutional price*		39 %	11 %
<b>QUANTITIES</b>			
Consumption (mio t)	15.9	<b>16.0</b>	<b>16.0</b>
Quota (mio t)	17.4	[17.4]	[17.4]
Cumulative increase in isoglucose production	-	0.3	0.0
Estimated EU production under quote	16.7	12.2	11.4
C sugar production	3.0	-	-
Total EU-25 production	<b>19.7</b>	<b>12.2</b>	<b>11.4</b>
<b>Total imports</b> (mio t)	<b>2.3</b>	<b>3.9</b>	<b>5.2</b>
of which ACP/India (mio t)	1.3	1.3	1.3
of which EBA/SPS (mio t)	0.2	2.2	3.5
of which MFN (mio t)	0.1	0.1	0.1
of which Balkans (mio t)	0.3	0.3	0.3
<b>Total exports</b> (mio t)	<b>3.1</b>	<b>0.4</b>	<b>0.6</b>
of which Non Annex 1 (mio t)	0.4	0.4	0.4
of which A & B with refunds (mio t)	1.1	0.0	0.2
of which eq. ACP (mio t)	1.6	0.0	0.0
* technical reduction of 11 % on Institutional prices in the No-reform scenario			
Source: EU (2005)			

These independent calculations confirm the EU's own assessments that predict a massive increase of LDC sugar under unchanged EU sugar prices (compare Table 1, column "No-reform").<sup>7</sup> The EU counted with 3.5 million tons of EBA imports in 2012/13 at an unre-

6 Indeed, 18 of 28 LDCs reviewed by LMC International (2004, 22) have highly distorted sugar markets with prices above 400 US \$ per ton.

7 It must be kept in mind that there is a strong degree of uncertainty in the supply response calculations, and both the EU and LMC/LDCs' sugar exporters could have good reasons to exaggerate the "danger"

formed price of 560 Euros per ton.<sup>8</sup> This means that, when keeping ACP-imports constant and reducing exports to 0.6 million tons (which will have to be reduced to zero if export subsidies, as defined by the WTO dispute settlement Brazil against EU, also include all direct and indirect (cross) subsidies, see Chapter 4), EU-production would drop more than 40 % to 12.2 million tons.

### 3.2 EBA impact on income generation and internal distribution

Up to here, the impact of EBA was only analysed at the aggregated national level and in terms of export and import volumes and gross values. Since in the political debate about EBA and sugar market reform distributional issues receive utmost attention, analyses on distributional impacts were reviewed. This review confirmed that “studies assessing the impact of preference erosion have largely disregarded within-country impacts across different parties” (Garside et al. 2005, compare also Tangermann 2002). Information on net income and distributional effects is indeed difficult to obtain or generate, which is partially due to the characteristics and limitations of the different methodological approaches described above:

- Sectoral approaches can look into the details of factor use and production of the sugar sector and its different players as well as internal adaption costs, but rarely do they consider economic opportunity costs. If sugar output and trade is increased e.g. due to policy reform, opportunity costs reduce gross revenue gains because production costs increase too, and alternative gains from the use of production factors such as land are not realized. On the contrary, if sugar production and export is to be reduced, the real loss to the exporter is lower than the gross revenue loss because of reduced costs and/or alternative uses of production factors.
- Microeconomic multi-sector approaches (farm-household, agricultural programming models, etc.) are able to look at some of these issues but most often do not incorporate interactions with non-farm sectors, or do so in a grossly simplified way, particularly concerning markets and their structures. In addition, such models are hardly existing nor are they available for sugar producers in LDCs.
- World general equilibrium models take into account alternative uses of production factors, markets and prices, and are thus able to distinguish between effects on the sugar sector and on economy as a whole, but they do this in a very superficial way specially for poor developing countries (if at all, see above), which makes sound evaluation of complex policy adjustments highly questionable. In particular, the ownership of production factors and the distribution of rents and value added and their changes have hardly been analysed. Very often, the central information provided by these studies beyond gross production and trade is national welfare which is generally dominated by price effects on the consumer side.

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of EBA exports – the one in order to justify stronger price cuts against the opposition of EU sugar sector, the other to convince the EU of its quota model – see Chapter 5).

8 The price reduction of 11 % in Table 1 is assumed to eliminate the effect of an assumed equivalent productivity growth in sugar beet production.

Another specific problem of the sugar sector is that sugar markets are particularly intransparent, even in Europe (Adenäuer et al. 2004). In most developing country cases, market price mechanisms are absent or profoundly skewed, and information on remuneration of cane producers, wages, administration, taxes, levies and profits is absent (Mitchell 2004; Larson / Borell 2005; Garside et al. 2005). Despite these limitations, several case studies seem to allow the following rough indications of distribution, in particular poverty orientation, of sugar production in LDCs:

In many LDCs, sugar is produced entirely within large enterprises, from cane to refinery (estates/mills). In these cases, workers' salaries constitute the bulk of the value added that goes to poorer sections of the population. In some case studies it is found that wage work in estates of sub-Saharan Africa is an important income source, better paid than other wage employment and significantly increasing household income (Tschirley / Benfica 2000; Pletziger 2003; Oxfam 2004) compared to local smallholder farming. Tschirley / Benfica (2000) relate their findings with African multi-country research that finds "*strong evidence of a positive relationship between total household income and the level and income share of off-farm earnings*".<sup>9</sup>

Many sugar companies in LDCs offer additional social services for their workers and even for the local communities.<sup>10</sup> There is no doubt that compared to western social standards and probably to standards in formal urban sectors in LDCs, these jobs do not provide comparable benefits. Non-governmental organizations (NGOs) in particular, are very sceptical of the role of large estates and sugar factories in providing adequate social benefits to workers and generally advocate smallholder sugar production (Forum Umwelt und Entwicklung 2004). However, the fact that local peoples' competition for jobs in sugar factories and estates is very high (Oxfam 2004) shows that it provides better conditions than local alternatives.

In some LDCs, a considerable proportion of cane for industrial sugar production is bought from farmers, for instance 70 % in Swaziland and 30 % in Madagascar (Buntzel-Cano 2005). This kind of smallholder production is overwhelmingly assessed as positive for poverty reduction. It is interesting to note that smallholder farms are also important providers of wage work, though the remuneration of workers is even lower than in estates (Tschirley / Benfica 2000; Forum Umwelt und Entwicklung 2004; Oxfam 2004).

In partial summary, the effect of sugar production on rural poor household incomes, through wage or smallholder remuneration, is generally (though anecdotically) described as positive in LDCs. However, it should be recalled that this is only to a smaller degree attributable to high price exports to Europe (the US has similar trade and preference

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9 The positive finding of relative high incomes of estate workers is contrary to some assessments for more advanced developing countries, particularly northern Brazil (Forum Umwelt und Entwicklung 2004).

10 The following passage refers to Southern Africa (Todd 2001): "*With the exception of Swaziland, governments in the region levy little or no tax on revenue from the sale of sugar under the EU and US preferential access arrangements. The sugar factories support large settlements, with the company typically providing or contributing directly to schooling, healthcare, and housing. The sugar producers are major employers in these countries. Their ability to assist with social provision stems in part from the high prices derived from the sale of sugar at preferential prices to the EU and, to a much lesser extent, the US.*"

agreements), the main reason being that local sugar prices are generally much higher than the world market and sometimes even the European price. In most countries, the share of exports is modest or very modest compared to local sales (only in Mozambique, Madagascar and Zambia the share of exports exceeds 40 %), and there are numerous indications that sugar prices in LDCs are very high compared to world market prices (LMC International 2004).

In fact, in most countries government protective trade policy, such as tariffs, licensing, consumption quotas, direct government trading etc. are the main reasons for these high prices, more important than the remoteness of the markets which is, however, true for some land-locked countries (e.g. Cooksey et al. 2003; Berkum van / Roza / van Tongeren 2005; LMC International 2004). For instance, the Southern African Development Community (SADC) has its own sugar protocol attached to its regional trade policy, regulating exchange between SADC members until at least 2012 (Lincoln 2005). The – in the national context – very large industries exert strong political influence on trade policies at national and regional level. This is at the expense of consumer interests who have to pay more for sugar. Taking into account that sugar provides on average 8 % of the caloric intake in developing countries (Chenoweth 2000), this is an important burden, and it is even higher on low income households who have a proportionally higher consumption of sugar (and other basic food) than high income groups.

The interests and objectives of these Government interventions are complex and not without contradictions. In several countries, Governments or organisations close to it such as pension trust funds, have invested heavily in the sugar industries (e.g. Ethiopia, Sudan, Madagascar). The labour unions of sugar industries, often privatised state enterprises, are among the only organised workers in these largely informal economies. By making them participate in the wealth they are converted into important allies who uphold protective policies. For some countries in Southern Africa, the threat of pending land reforms are an additional argument for estate and mill owners to distribute rents down to (potential) land holders, thereby increasing the number of beneficiaries of high sugar prices.

Overall, it seems that in many LDCs there is a positive impact of EBA exports on rural households directly involved into producing and transforming local sugar. Negative impacts on consumers are not directly attributable to EBA but to the general protectionism in the sugar sectors of LDCs, to which the EU sugar policy is indirectly contributing by providing arguments against more liberalised trade.

#### **4 Reasons and options for the reform of the EU sugar market**

As has been pointed out, sugar is particularly interesting within EBA since it is probably the only product which is both highly protected in the EU and for which a high (though still hypothetical) production capacity exists in LDCs. The high benefits are linked to the high EU sugar prices which are enshrined and assured in the EU sugar market order (SMO, see Box 2).

This SMO was scheduled to expire end June 2006. There were at least four reasons for the sugar market reform:

1) Since general reforms of the EU's Common Agricultural Policy have, since 1992, had a thrust toward lower prices and a decoupling of subsidies from production, the SMO is no longer in line with the EU's vision of agricultural markets. Apart from colliding with WTO rules (see below), the old price supporting policies are expensive, intransparent, producing oversupply and reduce competition. The costs of the SMO for consumers are estimated at up to 6 billion Euros.<sup>11</sup> Probably the lack of competition on the European sugar market is even more important than the lack of efficiency: neither country nor factory nor producer quotas are freely tradeable. The average national production costs within the European Union vary from about 250 Euros per ton to more than 600 Euros per ton (EU 2004). Also large efficiency differences between factories and farmers are reported. As a matter of fact, the majority of transfers from the SMO benefit the most prosperous farmers in the EU who own the best soils and are generally larger than comparable non-sugar producers. Since the relation of profitability between already reformed crops and non-reformed sugar has been growing in recent years, this has become a politically untenable situation.

2) In addition, increasingly sweeteners compete with sugar. A high sugar price makes such substitution more attractive. Halting such products would result in an ever growing extension of the SMO such as has already been the case for isoglucosis.

3) Export subsidies are claimed to be the most trade distorting policies and are particularly attacked in the WTO for many years. For the time being, under the Uruguay Agreement on Agriculture country schedule, the EU is still allowed to use some export subsidies, in the case of sugar, up to 1.3 million tons and 500 million Euros. Until recently the role of indirect export subsidies such as those incorporated in food aid, export credits and cross-subsidisation of exports through different mechanisms from internal support was rather unclear. In the case of cross-subsidisation, in the finding of a WTO dispute settlement on dairy against Canada in 2001 it was announced that cross-subsidisation was generally disputable. The WTO-case Brazil against the EU sugar exports went a step further. In April 2005 the appellate body made clear that the EU indeed had subsidised exports of up to 4.2 million tons of sugar in 2001/02 in different ways: 2.8 million of indirectly subsidised C-sugar and 1.6 million tons of ACP sugar (WTO 2005a). At least the exports exceeding the Uruguay commitment must be reformed within 15 months. However, in the medium term most probably all kinds of export subsidies will have to be eliminated.<sup>12</sup> This requires substantial reduction of sugar supply to the EU (production and imports, or extremely costly and disputed internal disposal or conversion).

4) Under the present SMO, state intervention agencies would theoretically have to purchase all sugar if the sugar price paid to factories falls below the intervention price. In the past, intervention has been extremely rare (last in 1986) given the very high import protection and additional internal market imperfections, for instance signs of oligopoly market

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11 On the size of welfare losses opinions differ because they depend, *ceteris paribus*, on transfer efficiency of the SMO on which estimations differ (Licht / Hussinger / Sofka 2003).

12 Already the Doha Declaration promises "*reductions of, with a view to phasing out, all forms of export subsidies*". It is generally assumed that after the expiry of the peace clause of the Uruguay agreement on agriculture in 2004 which protected many subsidies against disputes, and latest after the end of the Doha Round, disputes against all kinds of subsidised exports will be eased and will increase in frequency (Josling 2003; Oxfam 2005a).

behaviour of the sugar industries (Monti 2003). The lack of factual intervention is a constitutional and well planned element of the SMO since this prevents it from causing EU budget expenditures and thus major pressure for policy reform. Instead, a combination of subsidised exports (see above) and high import protection held internal sugar price above intervention price. For the moment, sugar import protection is extremely high (see Box 2). But a general improvement of market access in connection with the ongoing WTO Doha Round is likely to require the EU to reduce its agricultural tariffs. The price reform scenario would allow reduction of these tariffs by up to 60 %, the other scenarios would not permit more than 36 % according to EU (2003). It is, of course, not yet clear what the market access negotiations – the most complicated pillar of the WTO agricultural negotiations – will yield.<sup>13</sup> The decisive factor will be how many so called sensitive products with less ambitious market access improvements will be available for WTO members. If many sensitive products can be selected, many sugar products could be included in the EU sensitive product list, but with few numbers of sensitive products available this is less probable since there are products which are politically more sensitive to EU agriculture, particularly milk and meat products.

In addition, it must be taken into consideration that many products contain sugar. Their tariff reduction will disadvantage the EU sugar consuming industry on the EU markets *vis-a-vis* competitors who can use cheap world market sugar. And as export subsidies will be faded out which help compensate for competitive disadvantages of transformed sugar on the world market, the sugar consuming industry will suffer double. This industry is a far larger industry (though with less concentrated interest on the sugar price) than the sugar producing industry, and it has mobilised its influences to lobby for lower prices (CIUS 2004).

However, whether these arguments would have been sufficient to reform the SMO profoundly is questionable. In fact, the best shield against reforms has been that, in contrast to most other agricultural market orders, the transfers are not weighing on the EU budget but are almost entirely financed via (hidden) higher consumer prices. Even most export subsidies are financed through levies on factories and producers which of course ultimately are financed by consumers. That it is not costs but the desire of the EU to create more competitiveness in the EU sugar sector that has driven the reform agenda of the SMO will be shown in the next Chapter.

## **5 The reform of the sugar market order and the role of EBA– the Trojan horse**

The reform alternatives for a SMO after 2006 were theoretically open, and the EU commission (EU 2003) underscored that openness by presenting four different scenarios:

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<sup>13</sup> In order to assess the possible dimension of market access commitments: The US proposal stipulates tariff reduction of about 80 %, the EU is proposing 46 % on average with higher commitment for products with high tariffs. At the same time the EU seeks to use the concept of sensitive products extensively to exempt certain products from these high commitments – it proposed 8 % of all tariff lines to be eligible as sensitive, whereas the US would allow only 1 %.

- a. a continuation without reform including a small “natural” price reduction of 17 % until 2015 (compare Table 1);
- b. the complete liberalisation with a price drop of 42 % against the no-reform scenario;
- c. a price reform with, as a central element, the reduction of the internal white sugar price of 25 %;
- d. a quota reform with fixed quotas at a level corresponding to the no-reform scenario<sup>14</sup>.

After long discussions, in July 2004 the EU proposed a reform with a price reduction of 33 % for the institutional (white sugar intervention) price, which would mean beet price reduction of 37 % (EU 2004). This proposal came before the WTO had declared a large proportion of the sugar exports as illegal under the old Uruguay agreement on agriculture. In order to further reduce supply, the price drop was later increased to 39 % (43 % sugar beet) in order to further production and imports (EU 2005).

On November 24, 2005, EU agricultural ministers agreed to the reform proposal. This step is seen to be the decisive hurdle within the EU reform process. The final shape of the reform is as follows (CTA 2006):

- a reduction in the guaranteed price for white sugar of 36 % over four years, beginning in the 2006/07 season;
- the introduction of compensation to sugar-beet farmers ‘at an average of 64.2 % of the price cut’, through a ‘decoupled’ payment linked to ‘cross compliance’ which will form part of the ‘single farm-payment scheme’;
- the payment of an additional ‘coupled payment’ equivalent to 30 % of the price cut for a transitional period of five years plus the possible payment of ‘limited national aid’, but only for ‘countries which give up more than half of their production quota’;
- the establishment of a ‘voluntary restructuring scheme lasting four years for EU sugar factories and isoglucose and inulin producers, consisting of a payment to encourage factory closure and the renunciation of quota’; the aim of the restructuring fund is to: ‘encourage less competitive producers to leave the industry’; finance social and environmental adjustment costs and provide funds to most affected regions to diversify; payments will be 730 Euros per ton in the first two years, falling to 625 Euros in year three and 520 Euros in year four;
- the funding of restructuring measures through a special levy placed on remaining quota holders over three years of the transition;
- the introduction of scope to use restructuring funds to compensate beet producers affected by factory closures (reportedly up to 10 % of the amount);

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14 The fixed quota scenario does not affect the EU production level – on the contrary it foresees for the same total production higher EU-production levels than the no-reform scenario and slightly lower imports, assuming that the bulk of the quota reduction would be imposed on LDCs.

- the establishment of a ‘diversification fund for member states where the quota taken up is reduced by a minimum amount, with diversification funds increasing the more the quota is renounced’;
- the merging of the ‘A’ and ‘B’ quotas;
- a provision for the use of non-quota sugar in the ‘chemical and pharmaceutical industries and for the production of bio-ethanol’;
- the allocation of an additional quota of 1.1 million tonnes to ‘C’ sugar-producing countries against ‘a one-off payment corresponding to the amount of restructuring aid per tonne in the first year’.

The detailed modalities for the implementation of the reforms have yet to be fixed. Also tariff reductions are not (yet) decided upon, they will mainly depend on ongoing WTO negotiations (see above). In this context it is interesting that the intervention agency will be maintained during the four-year transition period followed by ‘the introduction of a private storage system as a safety net in case the market price falls below the reference price’.

The list of measures shows that the compensation of European actors will be substantial. According to data from Oxfam the European farmers will in the four-year transitional phase receive annual compensations from the EU of first 900 million Euros which will then increase to approximately 1.5 billion Euros from 2008 (AgraFacts 2005). The sugar industry will in the course of the four-year transition period, receive a contribution estimated at approximately 6 billion Euros for the deactivation of capacities (Handelsblatt 2005). The latter compensation will be borne by consumers.

In order to understand the role that EBA has played in pushing and shaping the reform, the contexts have to be further analysed. EBA was not the only reason, but instrumentally a central one, particularly in pressuring for a certain way of reform – the reduction of prices which was vehemently opposed by all EU and preferential sugar producers as well as most NGOs (see Chapter 6). The EU commission argued since 2003 that the unquoted EBA-commitments would swamp the market with sugar which would have to be reduced from EU production quotas. A quotation of EBA imports, together with quotas on EU production, was refused mainly on international credibility over EBA:

*The option of returning to fixed quotas would require the Community to go back on its international commitments like the Everything But Arms initiative, which opens up the Community market to all products from the least developed countries (LDCs). The EBA initiative is one of the pillars of the agricultural proposal on market access in the WTO and other international fora. Reintroducing tariff quotas would exact a high political price and harm the Community’s credibility. (EU 2003, 18).*

The quota for EBA imports was refused although this was the demand of the EU-industry and of sugar producing ACP countries (see above). Even LDCs themselves offered to restrain their preferential exports to the EU to 1.62 million tons per year for an extended transition period until 2019 in exchange for maintaining of the present price level (LDC sugar group 2005). A new alliance of developed and LDC countries and sugar producers emerged, united by the aim of maintaining a high price quota based EU sugar regime. Most NGOs supported that proposal (Forum Umwelt und Entwicklung 2004; Oxfam 2005b) which for several was in opposition to previous protests against EBA quotas and claims for unrestricted access.

Is it credible to believe that the quota system was dropped because of commitment with LDCs against their own expressed position? Most certainly not, as also some other reasons for reform have proven to be less evident:

- 1) The EBA imports could have been absorbed by stronger cuts into own production quotas. The EU estimated the additional production between the no-reform and the price reform (–39 %) scenarios to be about 1.3 million tons (Table 1). The need for exports and export subsidies could have been prevented via quota system or export taxation. In contrast to widely spread beliefs, WTO has not imposed a certain type of reform, but has only stopped illegal export subsidies: “the European Communities' obligations to the ACP countries are to *import* certain quantities of ACP sugar, whereas the European Communities' obligations in the present dispute relate to *exports* of the European Communities' own subsidized sugar” (WTO 2005b, 17).
- 2) The voluntary export restraint of LDCs could have been allowed via a WTO waiver for a very long transition period.<sup>15</sup> If not, a larger cut in EU production would have been necessary – this is the position of most NGOs.
- 3) The high costs of the present SMO do not really seem to be an argument for reform: the reform with its manifold compensations (see above) is said to be “budget neutral” (Handelsblatt 2005), thus not saving any money.
- 4) The sugar system change is not as radical as presumed: the sugar price will remain at 404 Euros per ton, thus most probably about 100 % over the long-term world market price level. Quotas will remain the major instrument for production allocation.
- 5) In contrast to stated free market access for LDCs, a clause has been introduced to ‘review’ EBA sugar exports to the EU should they increase by more than 25 % year on year (although it has been assured that this will only be used in case of illegal triangular transactions, it is a handicap for investors’ planning in LDC).

Rather, some other arguments will have played a more important role. Beyond the already mentioned ones which figure in official discourse, some underlying arguments can be deducted from the evolution and final outcome of the reform process in which the EU commission acted against almost all sugar actors involved:

- 1) The present inefficiencies induced by the SMO is probably the most important one. In effect, the major result of the price reduction and accompanying compensation scheme will and is aimed to be the elimination of high cost sugar producers and a concentration of sugar production in the most efficient countries (France, Germany and to a lesser extent Netherlands, Austria, UK, Poland and Slovenia) and regions. This principal aim of competitiveness is underlined by the fact that an additional amount of 1.1 million tons plus non-quota industrial sugar will be made available.

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15 Although it must be stated that voluntary export restraints are illegal under WTO law, exceptions such as the Multi Fibre Agreement exist.

- 2) Once sugar production is concentrated on fewer countries, it will be politically easier to introduce additional reforms (after 2015). The political process of policy reform in the EU is hampered by the need to find majority if not unanimity among all member countries. In view of the high rents that accrue with the extremely high price of sugar even for marginal producers, it would have been politically more than difficult to push through any meaningful selective production cuts in weak regions in favour of the competitive regions. Uniform reductions would only have served to further undercut the overall international competitiveness of EU sugar.
- 3) The alignment of the sugar market with the trend of the CAP towards world market prices and decoupled income transfers not only does justice to other non-sugar farmers but also clearly signals that this trend is definite. It discourages fights about reversal of these reforms. The “sacrifice” of northern European countries (in absolute terms they lose more than the southern countries who produce less and at higher costs) will pave the way for the reform of the remaining unreformed markets (olives, cotton, vegetables) where even more heavy resistance is to be expected since the southern countries are more dependent on agriculture and have less funds to compensate and restructure farmers and rural areas.
- 4) The space for manoeuvre in WTO is clearly enhanced, not only by permitting higher tariff reductions but most probably also by reducing the amber box subsidies, since after four years (with the end of the price reduction phase) the intervention mechanism will be given up in favour of a private stockholding scheme.

## **6 Impact of the SMO reform on developing countries, particularly LDCs**

Following the EU commission prediction (Table 1, column “reform”), the first proposed sugar price reduction of 39 % would reduce EBA sugar exports by roughly 1.3 million tons or 1.1 billion Euros. EBAs are by far the most affected group, whereas the ACP maintain their exports and EU farmers even increase production.

Similarly, Berkum van / Roza / van Tongeren (2005) find that the effect of a 33 % sugar price reduction in the EU compared to the present SMO (from 632 to 421 Euros per ton) is a 49 % reduction of exports (from 384 to 196 thousand tons) under a low substitution hypothesis and a 67 % reduction (from 2.7 million tons to 0.9 million tons) under a high substitution hypothesis, the latter one being more realistic in the long run (see above). This is calculated to cause a national income reduction of between 14 % (from 433 million to 382 million US \$) and 58 % (from 1.6 billion to 0.67 billion US \$) respectively, thus up to about 1 billion US \$.

LMC International (2004) predicts the sugar supply to the EU from LDC to be reduced by 2.1 million tons (from 2.7 to 0.6) when the EU sugar price drops from the base line 20 % to 33 % at an IRR of 20 % required by investors, and a reduction of even 2.8 million tons (from 3.9 to 1.1) at an IRR of 10 %. Countries that would stop EBA sugar export include DR Congo, Laos, Madagascar, Nepal and Tanzania, whereas Ethiopia, Malawi, Mozambique, Sudan and Zambia would continue to export.

The LMC International study, however, also shows that the production drop is much less severe than the export drop since in most countries the internal prices are very high (compare comments on Figure 1). Therefore, export revenue losses have less consequences than if a politically unbiased lower, e.g. the world market (import parity) price would prevail. That should be the fundamental reason why the advantage of the alternative proposal of the LDC sugar group (LMC International 2005) based on a quota of 1.6 million tons and a 20 % price cut (see above), compared to the EU proposal of no quota and a 33 % price reduction, is calculated to be “only” 290–400 million Euros (the variance is due to alternative hypothesis on the sugar price development after 2009).<sup>16</sup>

How the computed income reduction induced by the reform of the SMO is affecting poor people is a difficult question. LMC International (2005) calculates that 122,000–146,000 labourers can be directly maintained with the alternative SMO reform based on quotas. But it seems logical that also the level of redistribution will be affected. In Chapter 3 it has been argued that the good remuneration of poor sugar employees and smallholders is partially explained by the existence of rents which sugar estates and factories gain from internal and external policy interventions. It is likely that the social benefits of sugar estates will be reduced in order to comply with lower rent margins. Todd (2001) supposes for southern Africa that “*the prospect of lower sugar prices ... implies that these [sugar] companies will find it increasingly difficult to support the same level of social infrastructure, and this will add to governments’ budgetary commitments in the region.*”

Whatever the exact numbers, it must be taken for granted that the income reduction in sugar exporting LDCs due to the SMO reform is substantial also for lower income groups (estate workers, small sugar farmers, local economies), at the order of 100–250 million US \$ per year.

## 7 Conclusion

The inclusion of sugar into the EBA initiative of duty and quota free imports of LDCs into the EU has had major repercussions for both the sugar markets of both the EU and the LDCs.

For the EU, EBA threatened to bring in a wave of sugar that, since re-export is restricted and will be even more so under recent WTO dispute settlement, would have to be completely reduced from EU producer quotas. On the other end, it extended vested interest in

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16 The indirect effects of the SMO reform on world markets and external protection of third countries can have an even larger effect on LDC sugar producers than the direct one. Two opposite effects can be expected: One is that due to the reduced sugar exports of the EU, world market prices tend to increase. The extent is debated, ranging from 5-40 % depending on degree of liberalisation and assumptions about supply reactions in major exporting countries, notably Brazil (Larson / Borell 2005). The other, partially related effect is that arguments to heavily protect internal markets will fade away, presumably leading to worldwide tariff reductions with second round effects on sugar production and consumption. In light of the high levels of current protection, this liberalisation effect could clearly outstrip any world market price effect in many countries. The combination of these effects would, in addition to the price level for producers, affect the internal welfare distribution between producers and consumers. These effects of the reform of the SMO are, however, the same for all scenarios involving a halt to EU sugar export, whether via price or quota reduction.

high sugar prices to more actors outside the EU, particularly important politically in the WTO negotiations.

In the end, the EBA was an extremely useful argument (a Trojan horse) for the EU commission to propose and impose drastic price reductions in order to improve competitiveness of the EU sugar production and improve the standing in WTO negotiations, instead of repairing the quota allocation system. This is in obvious contradiction to the positions of most other political players involved in the sugar sector: EU sugar producers and industry, countries, most NGOs, sugar producing ACP and EBA countries and producers. In addition, the reform opens up the battle field for future reforms after 2014. On the other hand it may be argued that EBA was an important argument to maintain the fundamental structure of the SMO and not to liberalise it completely.

If that effect of EBA was actually planned, then the EU commission (initially DG trade, but later obviously also DG agriculture) was very skilful in harmonising the EBA commitment with the SMO reform schedule. Until now, increased EBA sugar imports have not caused additional burden on the EU imports (and re-exports) since they were deduced from SPS imports.

For LDCs, EBA initially promised extremely attractive sugar prices, an investment and sugar boom. It is important to note that even under the new scheme, LDCs are still guaranteed a very high and stable sugar price with a comfortable time horizon and low price and political risk of export disruption. Important investments of several hundred million US \$ in competitive countries are still expected (LMC International 2004; Peltzer 2005). Inclusion of sugar into EBA is still a clear “development gift”.

However, the agreed price cuts will, compared with the initial promise and also compared to the alternative LDC proposal on a quota solution for the SMO reform, entail adverse impacts on the poorest countries by not guaranteeing the high prices. This will negatively affect the attraction for investor in the sugar sector. LDCs are the only group of countries for which the EU foresees substantial volume changes in addition to the price cut effects.

It is certainly economically not advisable to induce the creation of non-competitive sugar industries by exaggerated price guarantees, particularly under an international trade regime that strongly pushes for liberalisation at least in the medium term. Although investment and rents from export could be enhanced in the near future, later social costs of supporting unprofitable sugar industries and eventual breakdown could be extremely expensive. It is nevertheless politically and socially disturbing that the poorest countries are relatively the most important losers in the attempt to bring the SMO into line with economic rationality, just at the time that the poorer countries get access to it.

That leads to the question whether there should also be “compensation” for LDC countries. As shown, compensation for European farmers and industry is abundant and will absorb even the funds that hitherto have been used to re-export preferential sugar imports. Compensation for ACP countries is sparse in short term but probably better in the medium term. The claim for compensation for erosion of deep, bilateral, clearly calculable preferences is almost uncontested both generally (Tangermann 2002) and specifically for long

standing ACP sugar exporters.<sup>17</sup> Compensation of ACP countries for preference erosion in sugar exports to the EU would also alleviate the individually most import product and a large part of the general preference erosion that is calculated for WTO multilateral trade liberalisation. It is a stumbling block to the negotiations because such general preference erosion is very diffuse, difficult to calculate and to compensate.<sup>18</sup>

Compensation of EU sugar preference erosion for LDC, as mentioned, is more difficult to justify, to calculate and to allocate. In fact, in comparison to ACP sugar protocol suppliers, there are no established sugar sectors to which injury will be inflicted, or which have to be reformed or dismantled. The impact of the SMO reform depends heavily on what is the reference scenario: When the EBA initiative was established in 2001, there was discussion about reforming the SMO since at the latest 1992, when the MacSherry reform introduced the principle of less trade distorting support for many agricultural products. But the final reform proposal by the European Commission, foreseeing a massive price reduction was only proposed in June 2005 and adopted by the Council in November 2005. Real export surges of LDCs had been prevented by quotas.

Although the claim for compensation of LDCs is not as evident as that of ACP countries, there is a clear reduction of future income. Compensation in this case is cannot claim to counteract a real negative variation or injury due to EU action, but to substitute for the initial transfer promise. The amount could be just a fraction of the calculated losses, e.g. 25 % or 70 to 100 million Euros per year. The obvious lack of proportionality between compensation of EU and developing country producers would still persist.

Whether the compensation should consist of a cash fund or of other means such as trade preferences depends among other things on several strategic considerations which are not clear-cut: How the compensation is accounted for in the calculation of Official Development Assistance (ODA), and on the flexibility and orientation of such compensation compared with other ODA. This is because if, as must realistically be assumed, the origin of a

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17 For ACP sugar protocol countries, initial 40 million Euros for the year 2006 are already designed by the EU in order to elaborate adjustment plans. The EU has promised further assistance for adjustment via the support of National Action Plans. The Action Plans can include, according to local realities, measures to improve competitiveness of existing sugar industry, promotion of diversification, and measures for general adaptation. The amounts are not yet sure, aggregate losses are estimated at about 300–500 million Euros per year by various authors (Mitchell 2004; Gillson / Hewitt / Page 2005; Chaplin / Matthews 2006).

18 Preference erosion and its compensation is a presently hotly debated issue with the ongoing WTO trade talks. Some authors (Özden / Reinhard 2002) doubt that preferences have a positive effect on development, stressing instead negative impacts of preferences through inducement of wrong, backward oriented specialisation on uncompetitive industries, and the encouragement of political and administrative structures that are prone to clientelism and corruption. These negative effects of preferences would explain the weak of development of most preference receiving countries, particularly the ACP. Other authors find higher values of preferences (see Mold (2005) or Waino et al. (2005) for reviews). Particularly since the recent inclusion of preferences into CGE models, a growing body literature has acknowledged and quantified the costs of preference erosion (IMF 2003; Francois / Hoekman / Manchin 2005). The overall value amounts to some 200–500 million US \$. Tangermann (2002) discusses the different types of preference erosion and the possibilities to compensate them, basically distinguishing between specific, deep, unilateral preferences and unspecific, multilateral preferences. The IMF has established a Trade Integration Mechanism in 2004, but this is on a credit base and a policy has been designed to assist member countries to meet balance of payments shortfalls that might result from multilateral trade liberalization (IMF 2003). Page (2005) argues for a general preference erosion fund that could be funded by multilateral trade liberalisation winners.

cash fund will be the EU development budget, the additionality of such compensation fund over existing ODA is a pertinent demand but hardly obtainable. The EU has promised to increase its official development assistance (ODA) to 0.51 % of GDP until 2010 and to 0.7 % in 2015. All “additional” assistance will obviously fall into these ambitious target levels and will most certainly not increase the overall aid. However, if LDCs doubt that the EU promise will hold and that they will be the beneficiaries, or if they want to predefine the way additional ODA is spent, an additional promise for compensation would be worthwhile. At worst, these commitments for aid in exchange for preference erosion will shape the sectors to which ODA goes, e.g. to export development and not to health. At best, consistent and specific cross-sector development programmes linked to (new) export opportunities will emerge that address capacity constraints both internally and through ODA. In contrast, if additionality seems more important, preference erosion should be compensated by non-ODA compensation such as additional trade preferences e.g. in the service sector or through clearly improved rules of origin.

If a cash compensation seems more reasonable, the way of spending it could be similar to the ACP Action Plans, but a higher degree of flexibility could be applied, e.g. by earmarking a certain share for sugar and another one for exports in general, thereby supporting the diversification of EBA export structure (on the idea of subsidising exports from LDC see Hoekman / Prowse 2005).

A last word on recent developments of the world sugar market may recalibrate the negative aspects of the assessment of the EU SMO reform on LDCs: High energy prices presently increase demand for biologically produced fuel particularly in Brazil, thereby reducing sugar supply and increasing world market price for sugar. This relaxes the transitional phase of the EU reform for both the EU and the preferential suppliers. If this boom continues, there will probably be no “sugar case” in the future.

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