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Sugar

EU proposes radical sugar reform

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Approved by:
Norval Francis
U.S. Mission to the EU

Prepared by:
Peter Talks

Report Highlights:
The European Commission has published proposals to radically alter the shape the EU's sugar regime. The proposals center on a radical new quota buyback scheme, which would likely see the end of EU sugar production in southern Europe, eventually reducing sugar production in the EU by at least one third. There are also price cuts of 40%, with beet growers partially compensated through increased direct payments. The Commission will likely face considerable political opposition to the proposals. The Commission would like to get the reforms formally approved by November, though this target may be a little ambitious.

Includes PSD Changes: No
Includes Trade Matrix: No
Unscheduled Report
Brussels USEU [BE2]
[E3]

Summary

With tentative estimates of future EU sugar production declining by between one quarter and one third, the Commission proposals are calling for a rapid and radical overhaul of both EU sugar policy and the structure of the EU sugar industry, attempting to introduce market forces into a sector which has long been heavily regulated and maintained highly profitable operators. Even if the proposals inevitably get watered down slightly they still represent a radical and ambitious policy change from Agriculture Commissioner Mariann Fisher Boel.

With the current EU sugar regime due to expire in mid-2006, pressures have been building for reform of the EU sugar policy, one of the last major unreformed sectors of the EU Common Agricultural Policy (CAP). The EU sugar price is around triple the world price, and roughly one quarter of EU production has to be exported with subsidies. A WTO Panel also recently found against many aspects of the EU sugar export policy.

On June 22, the European Commission presented new proposals for the reform of the EU sugar regime. The proposals called for a 39% price cut, as well as offering a quota buyback scheme and some new quota that the more efficient sugar processors can effectively purchase through the Commission. This quota sale along with a temporary restructuring charge on remaining quota holders will finance the buy out. Beet growers will be compensated with direct income payments equal to around 60% of the value of the price cut they face.

The European Commission is keen to get the proposals formally approved (by the Council) by November in order to try and avoid any potential for EU sugar policy to become an issue at the WTO Ministerial meeting in Hong Kong in December. Should the legislation be delayed beyond the Commission's November target date, it could mean that processors and growers make production and planting decisions for the 2006/07 marketing year before the eventual outcome of the reform is known. However, many observers think that November may be an over ambitious target. In any case, proposals will need to be agreed by June 2006 at the absolute latest when the current sugar regime runs out.

Reaction to the proposals has been, unsurprisingly, strong – they effectively spell out the end of sugar production in the south of Europe – although most actors accept the inevitability that EU sugar policy needs adapting. The Commission, by having switched from using a stick (compulsory quota cuts in previous reform proposals published last summer) to a carrot approach, (voluntary quota buybacks with a reasonably generous offer that represents perhaps 10 to 15 years profits for some inefficient sugar producers), may have alleviated some political opposition to the proposals. Northern sugar producers such as France, Germany and the UK (quietly) favor the proposals as they give them a chance of creating a sustainable sugar industry post-Doha. Preliminary discussions are seeing the emergence of a substantial block of countries opposed to the proposals, composed of Poland, Italy, Spain, Ireland, Greece, Portugal and Finland. This grouping is more than sufficient to form a blocking minority. In addition, Latvia, Lithuania, Austria and Belgium do not appear to be particularly convinced by the Commission's proposals. The Commission will need to review in what form they can revise proposals to lessen opposition from some of these countries, without altering the fundamental principles of the reform. Beet growers have also voiced

strong opposition to the proposals as being “too drastic”, without, in their opinion, ensuring the sustainability of the sector.

The European Commission’s estimates are that EU sugar production will decline from 20 MMT to around 12 MMT by 2012, though with a possible quota buyback of around 4 to 6 MMT (with a current quota of around 17 MMT plus 3 MMT of over quota production), this would perhaps be the low end of future production estimates of perhaps 12 MMT to 14 MMT. The EU would cease to be a net exporter, instead becoming a net importer, with imports continuing from the ACP countries as well as increasingly from the least developed countries.

EU Sugar Reform Proposals

Reform Outline

- Prices of sugar and sugar beet cut around 40% in two steps between 2006/07 and 2007/08;
- Intervention and intervention prices to be abolished, replaced with a ‘reference price’ to act as a trigger for eligibility for private storage aid.
- Minimum beet sugar prices cut in two annual steps to €25.05, from €43.63 today. Prices paid to beet growers will be allowed to fluctuate ±10%;
- Beet growers to be compensated for 60% of the price cut through direct income payments;
- The current EU-25 quota of 17.4 MMT of sugar is maintained (no quota cut);
- The new regime will last for nine years from 2006/07 to 2014/15;
- A restructuring fund will be set up to buy back sugar quota. In 2006/07, quota can be sold back to the Commission by sugar processors for €730/MT, this amount falls by €100 to €105/MT/year to the final year of the buy back offer, to €420/MT in 2009/10;
- Processors keeping their quota will have to pay a restructuring charge the fund, set at €126.4/MT in 2006/07, €92.3/MT in 2007/08 and €64.5/MT in 2008/09;
- An additional 1 MMT of new quota will be offered for sale to current C sugar producers for €730/MT, the money will be added to the restructuring fund;
- No cross border quota transfers allowed (the 2004 reform proposals enabled cross border transfers);
- In 2010, the Commission can unilaterally reduce quotas to a ‘sustainable’ level once the restructuring fund has finished in 2009/10;
- No review of price and quota levels in 2008 (as foreseen in the July 2004 proposals);
- Sugar beet grown for ethanol/industrial uses eligible for the €45/hectare carbon credit/set-aside;
- EU sugar marketing year to be moved from July/June to October/September from 2007/08;
- A price reporting system to be established;
- Over quota production can no longer be exported as C sugar, but is to be carried over to the next marketing year, to be used as the first part of the following year’s quota. The Commission can additionally order some quota sugar to be withdrawn from the EU market for up to one year. There is also scope to introduce a policy similar to the super levy in the dairy sector, where over quota production leads to steep penalties to producers.
- EBA countries continue to receive unlimited zero duty access to EU sugar markets from 2009/10, with a minimum price for raw sugar of €303/MT;
- ACP and EBA imports of raw sugar restricted to EU sugar refineries, as in the previous regime. However, from 2010, the sugar processors can also compete with the sugar refiners for raw sugar imports.

The restructuring fund is expected to raise €4.5 billion, all of which the Commission expect to pay out. The envelopes for direct payments to beet growers are €907 m in 2006/07, rising to €1,531 m in 2007/08.

Overview of the reform proposals on EU sugar prices

EUR/MT	**Reference Period**	**06/07**	**07/08**	**08/09**	**09/10**
White Sugar Reference Price	631.9	631.9	476.5	449.9	385.5
Sugar Price net of Restructuring Amount	631.9	505.5	384.2	385.5	385.5
Restructuring Amount		126.4	92.3	64.5	
Price reduction (with restructuring amount)		20%	39%	39%	39%
Reduction in 'effective' price of sugar		-41.1%	-41.1%	-41.1%	-41.1%
Raw sugar reference price	496.8	496.8	394.9	372.9	319.5
Minimum Beet Price	43.63	32.86	25.05	25.05	25.05
Reduction		24.7%	42.6%	42.6%	42.6%

New Sugar Quota of 1 MMT to be made available to:

MT	**Amount**
France	351,695
Germany	238,560
Poland	100,551
UK	82,847
Netherlands	66,875
Belgium	62,489
Denmark	31,720
Czech Republic	20,070
Austria	18,468
Sweden	17,722
Lithuania	8,985

Reaction

EU Member State Governments

For the Commission proposals to be approved, a qualified majority vote (QMV) of EU Member States will be needed in the European Council[1]. Following working level discussions as well as preliminary discussions in the July Agriculture Council, Poland, Italy, Spain, Ireland, Greece, Portugal, and Finland could all be broadly described as opposed to the current proposals. This group would constitute a blocking minority, though the Commission and UK Presidency would be aware that it would not need many of these countries to switch to the pro camp for the proposals to be approved. Agriculture Commissioner Mariann Fisher Boel has denied that this group would constitute a blocking minority, no doubt aware that the modus operandi in Brussels is that concessions should ensure that opposition weakens.

[1] See GAIN Report E35003 for more details on how the EU voting structure works. The opinion of the European Parliament is also required, although it is non-binding.

Further, Latvia, Lithuania, Hungary, Austria and Belgium all have objections to aspects of the current proposals. The Commission will undoubtedly be looking at ways to address the concerns of these countries, without altering the fundamental lines of the reform.

Beet Growers and Sugar Processors

Beet farmers, represented by CIBE (Confederation of European beet growers) as well as EFFAT (European Federation of Food, Agriculture and Tourism Trade Unions) have fiercely criticized the Commission's plans, describing them as "brutal", arguing that the proposals go too far in cutting both prices and reducing production, leaving the sustainability of the sector at stake.

These two groups, in combination with CEFS (who represent European sugar processors) have presented that the proposals would lead to the loss of up to 25,000 jobs (out of 60,000 jobs directly linked to the sugar beet industry Europe wide). These figures are based on four out of every ten sugar factories closing down.

CEFS have also highlighted that the Everything but Arms scheme could also become a vehicle for widespread fraud should the proposals be approved

Consumers Groups

BEUC (European Consumer's Organization) welcomed the reforms but were critical that national quotas would be maintained, arguing that this would continue to restrict competition, thus ensuring that "consumers may enjoy little if any benefits in terms of lower sugar prices, whilst contributing heavily to the 'restructuring' of the sector through taxes".

Food Industry

European food industry groups (CAOBISCO and CIUS) have broadly welcomed the Commission's proposals, but are quick to stress that much more work needs to be done on the proposals to ensure that the EU sugar market becomes truly competitive.

Isoglucose Industry

The European Isoglucose industry has criticized the proposals, saying that the 300,000 MT increase in Isoglucose quotas will not enable the development of a competitive industry in the EU.

NGOs

NGO Oxfam has criticized the proposals for being "a harsh, blunt reform package that will hurt the most vulnerable", even if they support the need for reform. See Critique of the EC's Action Plan for ACP countries affected by EU sugar reform, OXFAM and WWF Joint Paper, June 2005, for more details.

ACP Countries

The ACP Countries in a communiqué have described the proposed reforms as "Reform too fast, too deep, too soon", citing that they would lose around €400 million income per year. According to Clement Rohee, Minister of Foreign Trade of Guyana and Ministerial spokesperson on sugar for the Caribbean Community (CARICOM), "It is impossible to overstate the devastating impact the price cuts and timescale proposed by the Commission will have on ACP countries. … Under these conditions the sugar industries in many countries will be simply unable to survive, while in other producing countries the so-called reform will inevitably lead to severe cutbacks with disastrous socio-economic consequences."

In contrast, Stefan Tangermann, in charge of Agriculture at the OECD has argued that while some ACPs will lose out, that they would ultimately benefit from the changes, with better results being achieved than if they remain dependant on what is effectively EU financial aid (as at the moment).

Least Developed Countries

The Least Developed Countries (LDCs) who benefit from the EU's Everything But Arms (EBA) initiative released a report arguing for the unlimited access to EU sugar markets from 2009/10 to be converted into a limited zero duty quota to try and ensure that the LDCs could continue to benefit from higher EU prices[2]. The 40% price cut in the reform proposals removes much of the benefit to the LDCs of their preferential access.

Analysis

The restructuring fund represents an ambitious and radical proposal by the Commission that seeks to reduce EU sugar production by up to 40% in a short space of time. The Commission has offered a carrot to sugar processors to voluntarily cease sugar production, sweetened by a €730/MT buy out. The buy out will also look more attractive to the less competitive sugar producers in the EU given the 40% cut in prices due to be rapidly phased in. The Commission also maintains a stick in reserve with the right to reduce quotas once the buy back offer has expired in 2009/10.

Back of the envelope calculations suggest that the buyback could lead to between 4 MMT and 6 MMT of the quota being bought back, out of current EU quotas of around 17 MMT. The restructuring fund could pay for towards 6 MMT of quota to be bought out.

It is not yet clear what the political reaction to the proposals will be – in their current form they would effectively lead to the end of sugar production in most of southern Europe as well as some of the New member States, although it is unclear whether these countries will be able to force the Commission to water down the proposals sufficiently to ensure the long term viability of sugar production in these countries.

Strong political opposition to the proposals could force the Commission to back track over aspects of the reform, including options such as reducing the price cut, increasing compensation to either beet growers or sugar processors, or giving Member States the right to veto sugar processors who wish to sell their quota back to the Commission. This would give Member State governments some degree of control over domestic sugar industries, particularly if they perceive that foreign owned processors may not operate in their national interests (by ending sugar production). This scenario could arise in some of the NMS, where west European producers own some sugar firms. A reduction in the proposed price cut of 39% may also be seen as unlikely, as this has been supported by Germany, France, the Netherlands, UK and the Czech Republic.

The 2005/06 marketing year also looks very difficult to predict, with a complex set of pressures due to the change-over from the current sugar regime to the new regime in 2006/07, an overhang of sugar from 2004/05 seen in sugar being offered into intervention for the first time in nearly twenty years, possible issues for the Commission to resolve in declassifying (reducing the annual quota) in October 2005, as well as any WTO Sugar Panel

[2] http://www.acpsugar.org/ldc/lmcsugarreporten.pdf

compliance issues that could arise. In addition, there are likely to be substantial cuts made to the MY 05/06 EU sugar quotas to ensure that the EU meets its Uruguay Round WTO export subsidy commitments. Quotas could be cut by around 10%, 2 MMT in October, a move which would likely lead to up to 2 MMT of additional EU sugar exports during MY 05/06.

The Commission has adopted a carrot rather than a stick approach to reform by offering a quota buyback. In addition, the more efficient sugar processors will probably welcome the proposals, which mean that they can try and reduce operating costs by not only maintaining current production levels but also they could marginally expand output through the 1 MMT of new quota that can be 'bought'. French and German sugar interests have been arguing for price cuts but not quota cuts, though they probably would not want to see cuts as deep as the 40% the Commission is currently putting on the table. A small European sugar processor recently went on record describing how French and German sugar interests are looking for price cuts to force inefficient producers (notably in southern Europe) out of sugar production as a means to be able to maintain the viability of their own businesses.

The Commission's impact assessment of the proposed sugar reform predicts a massive cut in EU sugar production, from 20.3 MMT to just 12.4 MMT by 2012/2013. Wildcards in the estimates include how much sugar is imported from the EBA countries, as well as how much quota is reduced by the restructuring fund buyback. The Commission estimates cited above of 12.4 MMT EU production suggest a higher level of EBA imports than earlier Commission estimates produced in November 2004. This change leads to the EU production decline perhaps being higher than it might otherwise be.

European Commission estimates of EU-25 Sugar Balance post reform

	Base Year	2012/2013 Reform	2012/2013 No Reform
Prices			
Institutional Price	631.9	385.5	560.0
Reduction		39%	11%
Quantities			
Consumption	16.4	16.0	16.0
Quota	17.4	*17.4*	*17.4*
Increase in Isoglucose production		0.3	0
C sugar production	3		
Total EU sugar production	20.3	12.4	11.4
Total Imports	1.9	3.9	5.2
o.w. ACP	1.3	1.3	1.3
o.w. EBA	0.2	2.2	3.5
o.w. MFN	0.1	0.1	0.1
o.w. Balkans	0.3	0.3	0.3
Total Exports	5.9	0.6	0.6
o.w. Non Annex 1	0.4	0.4	0.4
o.w. A/B with subsidies	2.5	0.2	0.2
o.w. ACP equivalent re-exports	1.6	0	0

Source: European Commission
Notes: MFN, most-favored nation. Non-Annex 1 is processed food products.

The level of estimated future EBA imports is clearly a wildcard in these forecasts. The November 2004 modeling exercise estimates between 1.0 to 1.5 MMT EBA imports at a refined EU price of €421/MT, depending on the level of swaps[3]. From the November estimates (which use the prices from the July 2004 reform proposals), the guaranteed raw sugar price for EBA and ACP imports is around €330/MT. In the June 2005 estimates, the guaranteed raw sugar price for EBA and ACP imports is around €300. It is not clear why the Commission have decided to alter their assumptions on EBA and swap trades in particular in the June modeling exercise, suggesting that a rather large proportion of EBA sugar production would be exported to the EU, despite the lower price and hence price differential with the world sugar price.

Commission Estimates of EU sugar production since September 2004

Published		**September 2004**		**November 2004**		**June 2005**	
	Base	Low Estimate	High Estimate	(Low EBA)	(High EBA)	Reform	No Reform
Year		2011/12	2011/12	2013/14	2013/14	2012/13	2012/13
Price Cut		7%	7%	33%	33%	39%	11%
Sugar Price	631.9	588	588	421	421	385.5	560
Consumption	16.3	16.3	16.3	16.3	16.3	16.0	16.0
Quota	17.4	13.4	14.4	14.6	14.6	17.4	17.4
Production under quota	17.3	13.3	14.3	14.4	13.7	12.4	11.4
Total Production	20.3					12.4	11.4
Total Imports	1.9	5.6	4.6	2.6	3.1	3.9	5.2
o.w. EBA	0.2	3.5	2.5	1.0	1.5	2.2	3.5
Total Exports						0.6	0.6
o.w. exports of A/B	2.9	2.6	2.6	0.7	0.5	0.6	0.6
o.w. non annex 1	0.4	0.4	0.4	0.5	0.5	0.4	0.4
o.w. with subsidies	2.5	2.2	2.2	0.2	0	0.2	0.2

Notes: The base year numbers for all three modeling exercises are virtually identical, except only the June 2005 exercise includes C sugar, the others only cover quota sugar.
Total Production is quota production plus C sugar production, only the June 05 estimates include C sugar (3 MMT in the base year, but no C sugar produced in 2012/13). The C sugar is exported, so in the base period, the total exports are 5.9 MMT.

Sources:
DG Agriculture's background notes on sugar reform, as presented to the Council - September 2004[4]
Addendum to Commission Background Notes with revised medium term PSD forecasts - November 2004[5]
Revised Impact Assessment, June 2005[6].

[3] Swap trade flows are the replacement of EBA produced and consumed sugar with world market imports so that the domestic sugar can be exported to the EU. The attractiveness of swap trade depends on the difference between world and EU prices, as well as freight costs.
[4] http://register.consilium.eu.int/pdf/en/04/st12/st12672-ad01.en04.pdf
[5] http://register.consilium.eu.int/pdf/en/04/st12/st12672-ad03.en04.pdf
[6] http://europa.eu.int/comm/agriculture/capreform/sugar/impact_en.pdf

How does the current EU Sugar Regime work?

Member States are given quotas, which they allocate to sugar processors in that country. Beet growers are allocated 'delivery rights' for an amount of sugar, to provide beet to the processors.

Currently, the EU sugar market operates with A and B quotas (the only difference between the two types of quota is that a levy is paid on B production, effectively receiving a lower price). A and B quota sugar can be sold on the EU internal market or exported (for which it is eligible for export subsidies). Over quota production is called C sugar. C sugar must be exported outside the EU without EU export subsidies. In the EU-25, typically around 17 MMT of A+B sugar is produced per year and around 3 MMT C sugar.

The price of sugar is backed by the availability to sell it to the EU for a price of EUR 632/MT (refined sugar). This provides a floor to the price of sugar in the EU. In practice, A+B quota sugar is usually sold at between 10% to 20% higher than this price.

The EU has long standing preferences with some of the countries of the ACP to import up to 1.6 MMT of sugar per year. The Everything but Arms (EBA) Regulation fully liberalizes imports of sugar from the 48 least developed countries (LDCs) by 2009. Both these sets of preferential imports are guaranteed to receive the high EU prices. To prevent any non-preferential imports, the import tariff is maintained at a prohibitive level.

With EU-25 sugar consumption at around 17.7 MMT, and EU-25 production around 20 to 22 MMT, with a further 1.7 MMT imported, around 4 to 6 MMT must be exported each year. However, as the EU price is around triple the world price export subsidies are used to bridge the gap between EU and world prices for up to 2.6 MMT. The remaining exports are C sugar exports, exported without subsidies.

In September 2004, the WTO ruled that the EU was in breach of its export subsidy limits of up to 1.254 MMT export subsidies. The EU had not been counting 1.6 MMT of sugar exported with subsidies against this limit (arguing that this was equivalent to the re-export of the ACP raw sugar preferential imports), not had it been counting C sugar exports. A WTO Panel rules that the EU should count both of these against its export subsidy limits, with C sugar being effectively cross subsidized by A and B quota sugar, which had an effect like an export subsidy according to the Panel.

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