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Trade Policy Monitoring

Estonia's Sugar Woes

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Report Highlights:
The European Commission found that Estonia should be fined EUR 46 million for 91,464 tons of excess sugar stocks at the time of EU Accession. Estonia contends that the fine is excessive as much of the sugar stockpiling was by consumers and not private firms. The Government of Estonia has brought the case to the European Court of Justice.

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The Dispute

Record quantities of sugar made their way into Estonia on the verge of its accession to the European Union - something which the EU took notice of. In January 2004, the European Commission adopted a regulation for the 10 new acceding countries which mandated that excess sugar stocks remaining after accession in May 2005 would be subject to fines.

Estonian sugar imports in 2002 reached only about 65,000 tons. However, in April 2004 alone, the month prior to EU accession, Estonia saw sugar imports of about 47,000 tons. As a result of the surge in sugar imports just prior to accession, Estonia and the EU are currently involved in a dispute at the European Court of Justice.

EU accession rules require New Member States (NMS) to comply with its common policies, amongst these being the EU's sugar regime. The NMS were only allowed carryover stocks of sugar that did not exceed "the quantity which could be regarded as constituting a normal carryover." In April 2005, the Commission extended the deadline for compliance with the excess sugar stock regulation. By November 30, 2005, the new EU members were mandated to: a) destroy the excess sugar stocks; or b) convert them into animal fodder or ethanol or export them as C quota sugar; or c) otherwise face a fine.

The fine was designed to prevent speculative purchases of sugar by business interests planning to purchase and stockpile subsidized EU sugar exports prior to accession and then selling the sugar post-accession at a significant profit margin.

In June 2005, the European Commission ruled that Estonia acceded with excess sugar stocks of 91,464 tons and levied a fine of EUR 46 million (approximately US$ 56 million). The fine represents about two percent of Estonia's GDP.

The Government of Estonia is making the claim at the European Court of Justice that about two-thirds of the excess sugar was purchased by consumers, not private industry, to be used for home production of canned goods such as jams and jellies. Thus, the fine should be reduced. This assertion is backed by research from the Estonian Economics Research Institute suggesting that Estonian consumers, indeed, took part in panic buying of sugar prior to accession for household storage. They also cite anecdotal evidence that when emergency service workers arrived at flooded homes in the seaside town of Parnu they found flooded basements full of sugar.

The EU, however, is not accepting Estonia's contentions that the fine should be waived or reduced because sugar was hoarded by households.

Estonia's Sugar Reality

In February 2005, then Estonian Prime Minister Juhan Parts wrote a letter to European Commission President Jose Manuel Barrosso urging the EU to lower the proposed Estonian sugar fine to avoid damaging support for the EU amongst Estonian citizens. PM Parts also claimed that 63,000 tons of the surplus was purchased and stored by panic buying consumers, not by private companies, and should thus not be subject to the fine aimed at speculative purchases.

A quick calculation distributing 63,000 tons of sugar amongst approximately 1.4 million Estonians indicates that the per capita pre-accession sugar purchases would have amounted to approximately 45 kilos – nearly 100 pounds per person. A family of four would have had to hoard about 400 pounds of sugar.

The European Commission did not set much store in this scenario. Referring to Estonia's claims regarding who purchased the excess sugar, EU Agricultural Commissioner Mariann Fischer Boel commented, "Imagine 91,000 tons of sugar in the cellars of housewives."

While the Commission may doubt Estonia's claim, EU news sources reported a buying frenzy of sugar, butter and other milk products just prior to accession. Even the Russian newspaper Pravda reported at the time that buying trends in Estonia were reminiscent of those seen during the Soviet collapse with consumers stocking up on certain foodstuffs and waiting in long lines at grocery stores only to encounter empty shelves.

To support their position, in January 2005 Estonia's Minister of Agriculture Ester Tuiksoo wrote to Commissioner Boel justifying such large consumer purchases. Minister Tuiksoo maintained that families purchased large quantities of sugar in 25-50 kilo bags in preparation for the traditional autumn canning of jam, jelly and berry syrup.

Why Hoard Sugar?

By the time Estonia acceded to the EU in May 2005, there was no longer a domestic sugar processing industry. Consequently, pre-accession Estonia took advantage of and was reliant upon the world sugar market where prices were three-fold less than within the European Union. In particular, Estonia had been able to take advantage of the EU's subsidized sugar exports.

As the European Commission saw it, various Estonian firms made a calculated choice to ignore the January 2004 regulation against excess sugar stocks and purchased significant quantities of sugar - more than was needed for production levels at that time - at the world market price to store within Estonia prior to EU accession. The decision to hoard sugar would have been most tempting to firms in the beverage, baking, and confectionary sectors, as well as wholesalers and retailers of sugar who were looking at a 300% price rise following accession.

Beyond households and commercial food processors, other likely players interested in stockpiling sugar were distillers of bootleg alcohol, mainly vodka. This could account for some of the sugar claimed to be for household use. In addition, beekeepers were suspected of having made significant purchases of sugar in order to feed bees during the wintertime.

Government of Estonia Reaction

The Government of Estonia (GOE) has filed a suit in the European Court of Justice requesting that the EU base the fine only on the amount of sugar which the GOE has determined was stockpiled by private companies (49,273 tons), excluding sugar purchased by consumers (42,371 tons). In addition, the GOE argues that the New Member States who acceded in May 2005 were not treated in the same way as past in accessions.

Estonia will most likely be required to first pay the fine and then wait to see if they win their case for a refund. To cover the cost of the fine, Estonia's Tax and Customs Board instituted fines against 27 firms that stockpiled sugar. Many of these companies have refused to pay any fine or destroy their sugar stockpiles. Only one company has chosen to convert their sugar into fodder or fuel. Most are fighting the imposed fines in court.

Some current and former politicians have criticized the EU sugar regime and have called for its demise as Estonia no longer has a domestic sugar industry of its own and the regime only leads to heightened costs for consumers and industry.

Estonian Industry Reaction

Kalev is Estonia's largest confectionary company with investments also in the baking and real estate sectors. During the last fiscal year Kalev reportedly lost 3.2 million dollars as a result of the three-fold price increase in sugar following EU accession. This was despite Kalev taking measures to increase confectionary product prices by 10 percent leading up to accession. According to the EU Commission and Estonia's tax authorities, Kalev held 15,600 tons of excess sugar resulting in a fine of EUR 6.4 million. Kalev filed suite against the Estonian Tax and Customs Board in July 2005, claiming that they did not own the sugar and as such should not be responsible for the fine. Kalev reportedly sold the excess sugar stocks to a third party.

Estonia's division of the Coca-Cola bottling group has said that it will not pay any fines for its sugar stocks and will take legal action to prevent it. The processed food company Felix is following the same line as Coke.

Who is to Blame?

The current sugar dispute is largely viewed as being the result of the GOE's pre-accession failure to properly prepare for adoption of the EU sugar regime and its impact on Estonia's food industry and consumers. In retrospect, some analysts have suggested that the GOE should have impeded the ability of firms to import increased levels of cheap sugar prior to EU accession. Import restrictions, such as the implementation of import tariffs on sugar, could have reduced or even eliminated any price incentive to import excess sugar stocks.

In June 2005, Estonia's State Audit Office (SAO) released their preliminary findings in regard to the sugar controversy. The auditors suggested that various GOE Ministers and their Ministries failed to work together to prevent the hoarding of sugar prior to accession. In hindsight, the SAO suggested that excise duties should have been placed on sugar as opposed to import tariffs because of their relative ease in implementation.

The SAO has also concluded that the political climate within Estonia during the period leading up to accession could have made it extremely difficult to establish the policies needed to prevent excess sugar stocks. In fact, the SAO found that the various Ministries and officials held many discussions regarding the prevention of excess purchases of sugar and other commodities but found the proposed measures too problematic to implement. In addition, the SAO found that the former Estonian Cabinet members were unable to work well together, contributing to an inability to institute trade measures in preparation for accession.

Post-Accession Reflections

Estonia's government and institutions have been lauded for their preparations for EU Accession. Estonia's Agricultural Registers and Information Board (ARIB) was awarded the EU Citizen of the Year Award for 2004 by the European Commission.

Unfortunately, the ongoing saga of the excess sugar stocks will continue to cost Estonia and its economy a significant amount of time and money. In future, the EU will need to ensure that acceding countries have reliable policies in place to prevent the panic stockpiling of regulated commodities.

Chronology

- **November 2003**: The European Commission adopted Regulation No. 1972/2003 on agricultural products which called for transitional measures to be adopted in regards to trade for the 10 acceeding countries.
- **January 2004**: The European Commission adopted Regulation No. 60/2004 on sugar which mandated that excess sugar stocks remaining after May 2005 would be subject to fines.
- **April 2004**: Estonia adopted their Surplus Stock Charges Act which enables the Government of Estonia to fine the firms which were responsible for and owned the excess sugar stocks.
- **April 2005**: The European Commission amended Regulation No. 60/2004 with Regulation No. 651/2005 to extend the period over which remaining stocks could be used without a fine. All excess sugar stocks remaining after November 30, 2005 would be subject to a fine.
- **June 2005:** The European Commission determined that Estonia's excess sugar stocks amounted to 91,464 tons.

Additional reports on the EU sugar regime can be found on the website of the Foreign Agricultural Service at the U.S. Mission to the European Union at www.useu.be/agri or through the FAS website at http://www.fas.usda.gov/scriptsw/attacherep/default.asp.