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Coping with the Fallout for Preference-receiving Countries from EU Sugar Reform

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Developing countries can produce sugar at much lower cost than it can be produced in the EU, yet reform of the EU sugar policy will result in both winners and losers among them. Reform will benefit competitive sugar exporters currently excluded from the EU market. It will adversely affect those developing countries that currently benefit from preferential import access to the EU's high-priced sugar market, while diminishing the benefits received by those least-developed countries to which duty-free and quota-free access has been promised after July 2009. This article identifies the countries likely to lose and the extent of their potential losses. It examines alternative proposals that have been put forward to assist these countries to adjust to the adverse effects of EU sugar policy reform and contributes to the debate by putting forward a further proposal.

Keywords: ACP countries, development, EBA initiative, EU sugar reform, trade preferences

Introduction

The EU Commission's initial proposal to reform the sugar Common Market Organisation (CMO) in July 2004 (EC, 2004a) and that of June 2005 (EC, 2005b) have stirred strong debate within the development community due to their likely implications for African, Caribbean and Pacific (ACP) and least-developed countries (LDCs) with privileged access to the EU market. The EU is a high-cost sugar producer and its highly supported production contributes to oversupply and lower prices on world markets, to the detriment of efficient, low-cost developing-country sugar exporters such as Brazil and Thailand. The need for reform of the EU sugar policy from a development perspective is accepted. However, development opinion is divided between those who argue in favour of maintaining the value of preferences by keeping a high EU support price and managing the market by severe quota cuts on the EU's own production, and those who call for the liberalisation of the EU sugar market (perhaps maintaining relatively low tariffs) with compensation for the preference-receiving countries that would be adversely affected by this reform.

This article evaluates this debate in the light of the Commission's own proposal for assistance to ACP countries and the arguments put forward by preference-receiving countries. The first section of the article provides the background to the debate through a brief overview of the current CMO of the sugar sector and the array of preference agreements contained within it. The main elements of the reform proposals are described in section 2. Section 3 looks at the likely negative impacts for the ACP countries and the LDCs respectively. Section 4 examines the proposals that have been put forward to mitigate these adverse effects, and in it we make our own proposals for the way forward. Section 5 summarises the arguments made.

1. The EU Sugar Regime and the Role of Preferences

The EU sugar market is heavily supported: the domestic price is about three times the world price. The EU sugar CMO is based on the use of import tariffs, the special safeguard permitted under the World Trade Organisation Agreement on Agriculture, export subsidies, production quotas and a guaranteed minimum price. There are two types of quota, A and B, both of which are set at the member-state level. The former approximates to national consumption, while the latter is exported with subsidies. A levy on the production of both A-quota and B-quota sugar finances the cost of export subsidies, so the internal support measures are largely budget-neutral. Production that exceeds quota (referred to as C sugar) is sold on the world market

without export subsidies. The high level of support is an important factor in the EU being the second largest sugar exporter in the world.

The EU sugar CMO includes several preferential trade agreements, which have created direct links between the price paid under the EU CMO and the price received by some developing countries. The most significant by volume is that with the ACP countries and India while that with the LDCs, the Everything but Arms (EBA) initiative, is of increasing importance. Other agreements cover imports from Brazil and Cuba (85,473 tonnes); overseas countries and territories (OCT) of the EU such as the Dutch Antilles (approximately 20,000 tonnes); and the Balkans (300,000 tonnes). The focus here is on the ACP and EBA agreements, since the other agreements are for relatively small quantities.

Under the agreement with the ACP countries and India, a total of 1,304,700 tonnes of white sugar-equivalent obtains the EU reference price duty-free. Each participating country is assigned a quota, which determines the quantities it is allowed (and required) to export to the EU under the agreement (table 1). Quotas were determined according to the historical importance of a given country as a sugar supplier to the UK. Thus, the main sugar traders with the UK during the colonial period have the biggest quotas: Mauritius has the largest, while Fiji and Guyana also have important shares.

Table 1 Distribution of Import Quotas by ACP Countries and India
(tonnes of white sugar-equivalent)

	Tonnes (white sugar-equivalent)	Percentage of ACP quota allocated
Barbados	50,312	3.9
Belize	40,349	3.1
DR Congo	10,186	0.8
Fiji	165,348	12.7
Guyana	159,410	12.2
Ivory Coast	10,186	0.8
Jamaica	118,696	9.1
Madagascar	10,760	0.8
Malawi	20,824	1.6
Mauritius	491,031	37.6
St Kitts and Nevis	15,591	1.2
Swaziland	117,845	9.0
Tanzania	10,186	0.8
Trinidad/Tobago	43,751	3.4
Zimbabwe	30,225	2.3
India	10,000	0.8
Total	1,304,700	

The EBA scheme allows duty free access to the EU market for the 50 least-developed countries, including 6 ACP Sugar Protocol signatories. Under the agreement, special provisions have been adopted for sugar to allow a gradual approach to full market access, which will be achieved from 1 July 2009. Until 2005/6, exports are limited by quota, which increases gradually to 129,751 tonnes. Between 2006 and 2008, quantity restrictions will no longer apply and customs duties will be gradually reduced by 20 percent, 50 percent and 80 percent. Only those countries that have signed the Framework Agreement with the EU are eligible to benefit from this quota access. Twenty-six countries have signed this agreement but, in practice, very few are net exporters and only a handful export to the EU (table 2).

Table 2 EBA Countries with Sugar Export Capacity (tonnes of white sugar–equivalent)

	2001/02	2002/03	2003/04 (expected)
Burkina Faso	7,073	7,237	7,672
Sudan	16,257	17,037	16,979
Ethiopia	14,298	14,689	15,249
Malawi	10,402	10,661	10,959
Tanzania	9,065	9,317	9,940
Zambia	8,758	9,017	9,538
Mozambique	8,331	8,384	10,116

Source: LMC, 2004

In addition to these imports, further quantities are imported from these countries as well as Zambia and Kenya as special preferential sugar (SPS) to cater to the needs of EU sugar refineries. The Commission established a ceiling, known as maximum supply needs (MSN), on total imports to the EU's seven sugar refineries. SPS imports make up the difference between the MSN quantity and the total arising from other preferential sources. Since OCT quantities vary according to their production levels, and EBA volumes are increasing annually, the shortfall that is imported as SPS also varies. SPS sugar receives a minimum price that is slightly below that of ACP/India sugar.

The value of preferences for a given country in a specific year depends on the volume of sugar the country exports to the EU under the Sugar Protocol or the EBA Framework Agreement and on the world price: the lower the world price, the greater the value of preferences. For the year 2003, we estimate the premium obtained by ACP beneficiaries to be about €476 million using actual volumes traded rather than quotas. This is close to the figure of \$470 million in 2001 estimated by Milner,

Morgan and Zgovu (2004). The distribution of the premium obtained from preferences is correlated to the allocation of quota amongst preference-receiving countries.

2. EU Sugar Policy Reform

Several factors have contributed to the need for the EU to reform its sugar CMO. SCAP reform has focused on shifting production-linked support to decoupled payments, so there is a desire to shift the sugar CMO towards this model. The EBA Agreement opens the EU to increases in sugar imports, with estimates of volumes varying from 900,000 tonnes (EC, 2001) to 3.9 million tonnes per year (LMC, 2004).¹ Due to the EU's self-sufficiency in sugar, any increase in imports will translate into an increase in exports, which is only possible with the use of export subsidies. The latter are constrained by quantities agreed under the WTO Agreement on Agriculture, so that an increase in LDC imports after July 2009 will require a one-for-one reduction in domestic EU production.

This pressure will be exacerbated by a successful outcome of the Doha Round if it results in the eventual elimination of export subsidies. This would require the elimination of B-quota production, which can only be exported with their aid. In addition, the panel in the WTO dispute brought by Australia, Thailand and Brazil concluded in 2005 that C-sugar exports should be included under export subsidy limits as should the 1.6 million tonnes exported annually with export subsidies, which represents an equivalent volume to that imported under the ACP protocol and SPS. Finally, the Doha Round negotiations are addressing the issue of high tariffs, which reduce market access. Any agreement to reduce tariffs and/or to restrict the use of the special safeguard measure would compromise the ability of the EU to retain the high internal sugar price.

In response to these pressures, the EU Commission put forward a reform proposal in July 2004, which was revised in the light of member-state reactions and the outcome of the WTO dispute in June 2005. The main elements are summarised and compared in table 3.

Table 3 Main Elements of the Commission Reform Proposals of 14 July 2004 and 22 June 2005

July 2004	June 2005
A and B quotas combined. 16% reduction in EU sugar quotas.	A and B quotas combined. No compulsory quota cuts until at least 2010. Additional 1 million tonnes of quota to be made available to C sugar-producing member states.
33% reduction in the white sugar guide price by 2007/8.	39% reduction in the white sugar guide price over 2 years (by 2007/8).
Cut in the raw sugar price from €523.7/tonne to €329. Raw sugar price to be cut over 3 years by 2008/09.	Cut in the raw sugar price from €523.7/tonne to €319.5. Raw sugar price to be cut over 4 years to 2009/10.
37% reduction in the sugar beet price, 60% will be offset by direct payments to farmers.	42.6% reduction in the sugar beet price. 60% compensation to EU producers.
EU sugar quotas previously allocated by country to be freely tradable Europe-wide.	Quota restructuring scheme in which closing sugar factories will renounce their quota.
Maximum supply needs ceiling abolished from 2009/10.	Maximum supply needs ceiling to remain in place. Between 2006–2009, 75% to be derived from ACP countries/India. Beyond 2008/9 this will hold for only the first 3 months of the marketing year. Other sugar processors to be allowed to import and refine raw sugar.

3. Impact of EU Sugar Reform on Preference Recipients

For ACP countries, the revenue loss on exports to the EU for sugar exported under the Sugar Protocol and the EBA Framework Agreement is estimated at around €250 million (table 4). These figures are likely to be an underestimate of the full impact on supplier countries. They do not allow for the fact that some countries may no longer find it profitable to export sugar at the lower EU reference price, even though it remains significantly above the world price level. Second, the loss to those

ACP states that are also EBA countries would be expected to grow over time as their access quota increases up to 2009/10 and they have full access after that date. Third, the setting of a minimum level of 75 percent of maximum-supply-needs sugar to be sourced from ACP countries/India does not include SPS quantities. This will open the way for refiners to substitute EBA sugar for SPS, which will adversely affect those non-LDC ACP countries that currently supply SPS. For LDCs, SPS can simply be exported as EBA sugar, under which terms they will not be subject to varying quotas. However, for non-LDC countries, this will represent reduced access to the EU market, and effectively a loss of preferences. The major SPS supplier in this category is Swaziland (table 4).

For the purposes of discussing the impacts of reform, ACP countries can be broadly classified into three groups: ACP LDCs, ACP non-LDCs with available alternatives and ACP non-LDCs in cyclonic regions.

ACP LDCs have the potential to offset losses on their current quota exports to the EU by increasing their export volumes under EBA. Some of these countries are competitive, low-cost producers such as Zambia, Malawi and Zimbabwe. Also, for these countries as well as Kenya, the EU currently represents only a small proportion of their sugar exports. Benefits from the reform may be obtained in third-country markets where competition from the EU will be reduced as a result of the reform lowering production and, therefore, export volumes. However, the magnitude of this effect may not be that significant. The reform will lower EU sugar exports to the world market, which would in turn be expected to result in an increase in the world price. The impact of this will largely depend on whether Brazil will replace these volumes on the world market. Brazil is the world's most competitive large-scale sugar supplier, with a very elastic export supply capacity at the current world price (Koizumi, 2003).² Any upward movement in the world price as a result of EU sugar reform will be very limited because of Brazil's elastic export supply.

Apart from uncertainty about the size of any world price increase following EU reform, the extent to which individual preference-receiving countries will gain will also depend on the proportion of their exports to non-EU markets and the extent to which their exports benefit from preference agreements with other countries. Countries that export to the United States under preferential agreements, for example, will not benefit from any increase in the world market price for those exports. Zambia, whose main export market is DR Congo, is the only ACP or EBA country likely to benefit from any world market price increase.

For non-LDC ACP countries with a high dependence on the EU market, the adjustment problems will be greater. In all cases, sugar is an important agricultural

crop, and as such, plays an important role in their rural economies. Countries that will suffer the highest absolute losses are those with the largest quotas, namely Mauritius, Fiji and Guyana. These three countries are all high-cost producers, with costs that are more than twice those of low-cost ACP producers such as Swaziland, Zambia and Malawi. Their high-cost structure has arisen largely as a result of having had a secure export market for a long period under the ACP protocol. The high price has become institutionalised, leading to a lack of competitiveness on the world market (Larson & Borrell, 2001).

The impact assessment of sugar reform carried out for the European Commission suggests that, at the proposed lower price, sugar production will no longer be financially viable and will cease in Mauritius and Guyana (EC, 2003). Mauritius is attempting to restructure its sugar sector and to reduce its reliance on sugar through the development of tourism and financial services. It is the sheer size of the sugar transfer that makes adjustment difficult for Mauritius. For Fiji, sugar has been replaced by tourism as the main source of foreign exchange revenue, thereby reducing reliance on sugar in the economy as a whole. However, the reform will still affect rural areas where sugar is grown by small-scale farmers. Inefficiencies remain within the sugar sector that could potentially be reduced, thereby maintaining the profitability of the sector despite the reduced price. Guyana has recently invested in a new sugar mill that will increase output. Through this it expects to reap some benefits from the predicted exit of some other ACP countries from sugar production. The precise position of Guyana appears ambiguous, with some studies suggesting its production may be in danger (EC, 2003; Gillson, Hewitt and Page, 2005) and others that it should survive (Gillson, Hewitt and Page, 2005). Swaziland is a lower-cost producer than the others in this group, which could provide it with scope to benefit from the exit of other ACP countries. Overall, for this group, the reform will seriously affect sugar revenues, but adjustments are underway to counteract the effects.

The group of countries that gives rise to the most concern in relation to the reform are those in cyclonic regions in which sugar cane is virtually the only crop that can be grown. This results in highly specialised agricultural sectors with little potential to diversify. Not only are their agricultural incomes and exports heavily reliant on the sugar CMO, but they are also high-cost producers. Jamaica, Barbados, Trinidad and Tobago and St.Kitts and Nevis even have production costs above the EU average (Kerkela & Huan-Niemi, 2005). Even if land prices adjusted to the lower sugar price in the long run, their production costs would still need to fall in order to match those of competitive producers. This would require investment, which may not be justified given the extent of their uncompetitiveness and thus the low potential returns. Hence,

these countries are all likely to exit sugar production under the proposed EU sugar reform (Gillson, Hewitt and Page, 2005). For these countries, climatic constraints give limited scope to diversify into other export crops in order to offset losses. Furthermore, there is little evidence that these countries have engaged in adjustment in anticipation of reform of the CMO. Trinidad and Tobago have a lesser problem due to their natural resources of oil and gas, which provide foreign exchange revenue. Barbados and St.Kitts and Nevis both have tourist industries, which have overtaken sugar in importance to their economies, but these have been hit by the downturn in tourism since September 11th. Jamaica poses a greater problem in that, despite having a diversified economy, it suffers from high unemployment and debt levels of 150 percent of GDP. The sugar reform and the likely exit from sugar production are likely to exacerbate these problems.

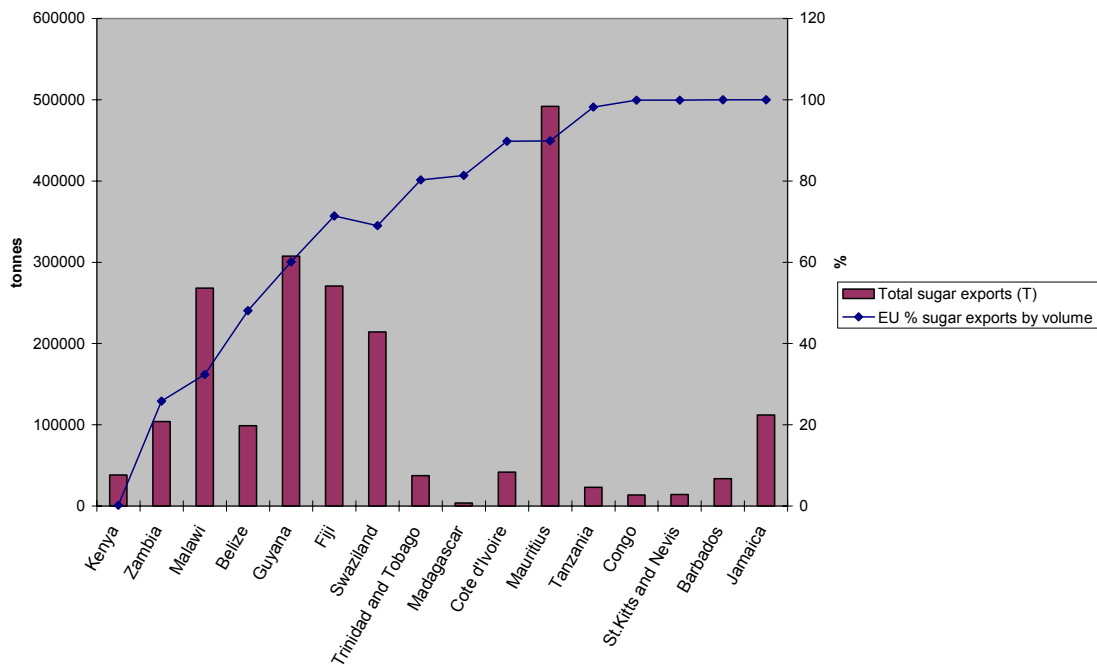


Figure 1 Total sugar exports by ACP countries and the proportion of their exports going to the EU

Table 4 Summary of the Importance of Exports to the EU to ACP Countries and the Expected Loss in Revenue Resulting from the Proposed Reform of 22 June 2005 Incorporating a Cut in Institutional Price and Elimination of SPS

	Year	Total sugar exports (T)	ACP quota	EU % of sugar exports by volume	Revenue loss from ACP and EBA quota	Revenue loss from SPS quota**	Total revenue loss from EU exports (€)
Belize	2002	98,858	40,349	48.1 (under ACP 40.8)	8,239,266	2,331,190	10,570,455
Barbados	2003	33,634	50,312	100.0	6,868,062.8	0	6,868,063
Congo	1995	13,715	10,186	99.9 (under ACP 74.2)	2,079,981.2	0	2,079,981
Cote d'Ivoire	2003	41,709	10,186	89.8 (under ACP 24.4)	2,079,981	8,826,872	10,906,854
Fiji	2003	270,582	165,348	71.4	33,764,061.6	9,014,251	42,778,313
Guyana	2003	307,642	159,410	60.1	32,551,522	8,248,796	40,800,318
Jamaica	2002	112,094	118,696	100.0	22,889,594.8	0	22,889,595
Kenya	2003	38,197	na	0.2		2,472,874	2,472,874
Madagascar	2003	3,708	10,760	81.4	757,173.6	0	757,174
Malawi	2003	268,241	20,824	32.4 (under ACP 7.7)	6,429,237	0	6,429,237
Mauritius	2003	491,973	491,031	89.9	100,268,530.2		100,268,530
St Kitts and Nevis	2001	14,052	15,591	99.9	2,869,418	0	2,869,418
Surinam	2001	2	na	100.0		647	647
Swaziland		na	117,845	69	24,063,949	9,711,000	33,774,949
Tanzania	2003	23,178	10,186	98.2 (under ACP 43.9)	3,982,512.6	0	3,982,513
Trinidad and Tobago	2002	37,425	43,751	80.3	7,642,185	0	7,642,185
Zambia	2002	103,976	na	25.8	5,477,829.994	0	5,477,830
Zimbabwe	2002	na	30,225	na	6,171,945*		6,171,945
Total		1,858,986	1,294,700		266,135,250	40,605,630	306,740,881

The impact of EU sugar reform on EBA countries differs from the impact on ACP countries due to the recent and still incomplete introduction of EBA. In the case of ACP countries, problems arise because the long-term effects of preferential access have become institutionalised in some cases. For EBA countries this has not yet occurred; thus, there is not the same degree of dependence on the sugar CMO. As a result of reform, EBA countries will generate lower export revenues in the future than they would have if the CMO were to remain unreformed. Thus, reform will affect the level of investment that can now be expected in their sugar industries. However, the sugar price in the EU even after the reform will still be well above the world market price due to tariff protection, so preferential duty-free access to this market will still be a highly valuable right. At the lower price, of course, fewer EBA countries will find it attractive to supply this market. But if the sugar industry in these countries cannot become competitive on the basis of the preferential margin of 75 percent or so that will continue to exist, it is questionable if such countries should be in sugar production in the first place. The price cut resulting from the reform will reduce the potential negative effects of becoming dependent on preference agreements in the long term.

4. Proposals for Mitigating the Negative Impacts of Reform

The reform proposals will negatively affect preference-receiving countries through lowering their revenue from sugar exports to the EU. In recognition of this, two proposals have been put forward to mitigate the impacts, one by the EU, and the other by the ACP and LDCs.

The EU proposal (EC, 2005a) recognises the need to develop sustainable, country-specific strategies for adaptation that take into account the constraints and opportunities of the sugar sector both at present and in the future as well as national development strategies. It also emphasises the need for these strategies to be actively pro-poor as opposed to assuming that the poor would benefit through spill-over effects. Three main instruments for assistance are proposed: measures to improve competitiveness of the sugar industry; the promotion of diversification; and measures to address broader adaptation needs. In any country one or all of these approaches may be implemented depending on the national situation.

The Commission has not yet put numbers to the size of the financial package it is prepared to make available. The action plan states that “The total envelope for assistance will be based amongst others on overall needs of Sugar Protocol countries” (EC, 2005a, 13). The total will be divided into national envelopes, with additionally a common envelope for projects of general interest, e.g., at the regional level, and a

specific provision for administration costs. The Commission proposes to cover the cost through the “Development Cooperation and Economic Cooperation” instrument in the next EU budget financial perspective, to cover the period 2007–2013. Some provision for preparatory support for 2006, in the order of €40 million, is envisaged in the June 2005 proposals, and the Commission also highlights the availability of the FLEX mechanism in the Cotonou Agreement, which can support national budgets in case of significant losses of government revenues due to a shortfall in export earnings.

These proposals are worrying because of their uncertainty. Agreement on the budget financial perspective was expected at the June 2005 European Council meeting, but deep divisions remain between member states both on the overall size of the budget and on its composition. Also, there is no commitment that these funds will be additional to what has already been agreed will be available to the ACP countries under European Development Fund financing in any event.

The LDCs, supported by the ACP states, have sought to persuade the EU to follow a different reform path for the sugar CMO (LDCs, 2004). In order to avoid a major decline in the guaranteed price, the LDCs have offered to postpone the date for full liberalisation of their access to the EU market in exchange for a significant increase in the sugar preferential quota granted to the LDCs in the intervening period. Specifically, the LDCs have indicated that, rather than full access by 2009, they would prefer a system of quotas on imports. They have proposed a system to the EU under which

1. Existing import quotas for raw sugar would continue to increase by 15 percent annually to 2008/9, to reach 197,335 tonnes and thereafter remain static until 2015/16.
2. Between 2015/16 and 2019, tariffs would start to decrease, reaching zero by the end of the period.
3. A second quota would be set up to cover all types of sugar (i.e., refined as well as raw) starting in 2004/5 and increasing 15 percent annually to 2011/12, when it would amount to 1.425 million tonnes, after which it would then remain fixed until 2016.

The rationale behind this proposal is to allow a longer transition period (ten years) and to achieve “remunerative prices” (LDCs, 2004). It is believed that this would provide a more secure environment for investors, which would aid in attracting further investment in and development of the industry in these countries. The commitment of LDCs to promoting their proposal was confirmed and supported by the ACP countries in the Madrid Declaration of January 2005, through which they reaffirmed their

opposition to the CMO reform and agreed on the need for quantitative controls on EBA sugar exports to the EU (ACP/LDCs, 2005).

Neither proposal provides a panacea. The underlying philosophy of the ACP/LDC proposal, namely to organise trade volumes at high prices, is diametrically opposed to the logic of the sugar policy reform (Mandelson, 2005). It has the disadvantage that it could create dependency on a higher sugar price by EBA countries, thereby undermining their competitiveness on the world market and promoting investment in unsustainable sugar industries. In effect, it would only delay the inevitable bigger price cut without providing incentives for adjustment.

While the EU proposal goes some way in mitigating the impacts of the reform of the sugar CMO, it also has limitations. First, the time frame proposed for adjustment appears unrealistically short in the context of the barriers to increasing competitiveness and diversification in the affected economies. Poor human capital and infrastructure in many rural areas in ACP/LDCs limit the capacity to develop replacement enterprises and to attract outside investors. Developing diversified sources of income sufficient to mitigate the impacts of the reform in four years is a tall order. Previous experience with EU assistance to ACP banana producers also highlights the potential delays in transferring funds from Brussels given the need to make viable project proposals (NERA & Oxford Policy Management, 2004).

Second, the financing proposed to assist adjustment is nowhere near adequate. Internal support measures for sugar are largely budget-neutral, because the main burden of support falls on EU consumers. The majority of the sugar CMO budget arises as a result of the need to re-export an equivalent amount of sugar to ACP/Indian imports (around €800 million of the total CMO cost of €1.72 billion in 2004 (EC, 2004b)). EU sugar producers will receive a generous 60 percent compensation of their revenue loss, which will reach €1.54 billion once the full price cut has been implemented. A mere €40 million has been allocated to assist preference-receiving countries in 2006; furthermore, this will be financed from existing development fund resources and not from the agricultural budget. This is despite the fact that expenditure on the re-export of ACP sugar never benefited EU growers and should rightly be used as part of the ACP country compensation package.³

It is clear that a more innovative proposal which meets the objectives of both parties but without the drawbacks of the current proposals is required. We therefore propose that, over a ten-year transition period, the EU should continue to provide support to the sugar industries of particularly vulnerable ACP economies by means of a guaranteed price, which would initially start at the current level but which would gradually be reduced over the transition period to the level proposed by the

Commission in its reform proposals. Such support would take the form of a deficiency payment linked to specific quantities of production. This mechanism should complement the proposed structural adjustment assistance and would not be a replacement for it. This solution is compatible with the market orientation of the sugar reform proposal, it provides the additional breathing space that many of these economies require, and yet its self-terminating nature will avoid the problem of locking countries into unsustainable lines of production in the longer term. The criteria for eligibility for these deficiency payments would have to be worked out, but would be based on objective criteria of vulnerability, dependence on EU sugar earnings and scope for diversification. Those LDCs that currently benefit from preferential exports to the EU under the Framework Agreement should also be eligible for these payments. As the amount of the deficiency payment is reduced over time, additional resources should be switched to “second window” activities such as improving competitiveness and assisting diversification. The financial package for these activities should be calculated on the same basis as for EU growers, i.e., 60 percent compensation for the revenue loss. Given our estimate of the revenue loss of €250 million, the compensation package should increase to €150 million per year as the reduction in the raw sugar price is phased in.

Funding for this proposal should be found from the current expenditure on the CMO, which, as explained above, largely arises because of ACP exports. However, a promise has been made to provide 60 percent compensation to EU growers, so additional budget resources will be required. A further source of funding could be obtained by placing a consumer levy on sugar (DEFRA, 2005). This could be set at a level that would maintain the consumer sugar price at its current level, so that the gains from the lower producer price are not transferred to the consumer. This would reflect the fact that EU consumers are the main beneficiaries of the sugar reform. A further rationale would be to reduce the incentive to increase sugar consumption by EU consumers as a result of the lower price, thus avoiding exacerbating the problems of obesity and unhealthy eating.

5. Conclusion

The EU sugar CMO has an array of preference agreements with developing countries. That with the ACP countries is long-standing while that which benefits LDCs is of more recent origin and has not yet fully taken effect. Reform of the CMO will affect both groups in terms of revenue foregone. The impact will be greater for ACP countries due to the degree of dependence on the EU sugar price that has built up

over time. In view of this dependence, it is vital that the EU provide appropriate measures to assist these countries as they adjust to the new regime.

Both the EU and ACP/LDCs have put forward proposals to ease the adjustment process. The EU proposes to make adjustment assistance available, but its proposal is limited by its short time span, its unrealistic expectations regarding the possible speed with which alternative income-generating opportunities can be developed, and its inadequate financing. The ACP/LDCs' proposal could potentially lead to unsustainable investment in uncompetitive sugar industries in these countries, and its logic of a managed market is at variance with the thrust of CAP reform.

Our proposal is to complement the provision of structural adjustment assistance for a transition period with income assistance through a deficiency payment mechanism with a gradually declining guaranteed price. This would be compatible with the market orientation of the new sugar regime, it would avoid problems of delay in the disbursement of adjustment assistance, and it would limit the incentive to invest in unsustainable sugar industries in LDCs. The overall financial package should provide the same degree of compensation to ACP/LDCs as is being provided to EU growers, currently 60 percent of the expected revenue loss. Financing of this package can be found from the savings made in the current ACP-related expenditure in the sugar CMO. However, as the Commission has already laid claim to this to fund compensation to EU growers, it is likely that some form of additional revenue will be required. This could take the form of a consumer levy representing a proportion of the gains consumers would expect from the EU sugar reform, which would, in turn, have desirable health benefits for the EU.

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Endnotes

1. These differences reflect, in part, the reality that the EU price will be influenced by the level of imports, but exactly how is unknown. They also reflect different assumptions about the extent to which LDCs will import sugar to meet domestic consumption while exporting domestic production to the EU to avail of the more attractive preferential price.
2. A contributing factor to this high elasticity is the ability of Brazil to divert sugar currently used in its domestic ethanol programme to the export market if world prices rise. The recent rise in world oil prices, by increasing the attractiveness of ethanol production, will work in the opposite direction.
3. "For sugar, it is clear that concerning the ACP countries some compensation or some aid will have to be financed, but these elements will be financed within the normal budget lines for helping the third countries in the ACP, EDF or the special lines." Evidence of Mr Jean-Luc Demarty, Deputy Director-General of DG Agriculture, to the UK House of Lords European Committee, *The Future Financing of the Common Agricultural Policy, Volume II: Evidence, 2nd Report of the Session 2005-06, HL Paper 7-II*. London: The Stationery Office Limited, 2005.

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