



Commonwealth Secretariat



The ESA-EU EPA and Future Sugar Sector Relations

**Study commissioned by the
Commonwealth Secretariat**

Final

September 2007

By Dr. Paul Goodison

Disclaimer

The views represented in this report are those of the authors and do not necessarily represent the views of the Commonwealth Secretariat.

Contacts:

International Trade and Regional Co-operation Section
Economic Affairs Division
Commonwealth Secretariat
Marlborough House
Pall Mall
London SW1Y 5HX

Fax: ++44 207 747 6235

Table of Contents

	Pages.
1. Introduction	4.
2. Sugar in the ESA Region	4.
3. Reform of the EU Sugar Regime	8.
4. The EC's April 4 th 2007 Market Access Offer	12.
5. Renunciation of the Sugar Protocol	15.
6. Addressing a Fundamentally Different Market Situation	19.
7. Implications of the EU Sugar Sector Reforms for the ESA Region	21.
8. Responding to the Challenges Faced	31.
Annex 1: Sugar Production, Consumption, Import and Export Data for the ESA Region (1999-2005)	55.
Annex 2: A Review of Announcements of Sugar Sector Investment Plans in Southern and Eastern Africa	56.

1. INTRODUCTION

The specific EU duty free-quota free offer to ACP countries in the context of the EPA negotiations on sugar cannot be seen in isolation from the wider process of change which is underway. The principal elements of this wider process of change are:

- the evolution of CAP reform and its application in the sugar sector;
- the evolution of EU and global markets for food and agricultural products;
- the corporate restructuring underway in the EU sugar sector where companies are increasingly diversifying, with some “going global” in their operations;
- EC preparations for renunciation of the sugar protocol (with all the implications this carries).

Within this context the primary factors driving the EC policy changes needs to be identified so that the policy response can be situated within a realistic framework. This then will provide the basis for assessing the implications of the EC April 4th offer and the development of an appropriate ESA policy response designed to address the specific challenges arising from these inter-connected processes of change which are underway.

2. SUGAR IN THE ESA REGION

- An Overview of ESA Sugar Production

Of the 17 ESA countries (including Tanzania), 8 are members of the sugar protocol, with 5 of these members also being least developed countries¹, while 3 additional least developed countries have a current or immediate potential interest in exporting sugar to the EU market under the EBA. Two ESA countries are potentially eligible to export sugar to the EU market under the EBA but do not currently do so, while 4 countries have no interest in sugar exports to the EU and are primarily concerned as consumers of sugar.

Non LDC Sugar Protocol	Sugar Protocol+EBA	EBA Sugar Exporters	Non Sugar Exporters
Kenya Mauritius Zimbabwe	Madagascar Malawi Zambia Tanzania DRC	Current Ethiopia Sudan Uganda Eligible Burundi Rwanda	Seychelles Comores Eritrea Djibouti

¹ Madagascar is something of an anomaly, it is eligible to export under both the sugar protocol and the EBA but is not exporting sugar. DRC has recently started taking up quotas under the EBA initiative supplying 11,680 tons of sugar under the EBA in 2004/5, 7,038 tons in 2005/06 and a projected 5,194 tons in 2006/07.

In 2005 the ESA region produced some 3,654,431 tonnes of raw sugar, consumed some 3,334,253 tonnes, exported some 1,179,820 tonnes and imported some 990,404 tonnes. Substantial new investment in sugar production and various forms of value added processing and revenue diversification is currently underway or planned across a number of countries in the ESA region, most notably in least developed countries.

ESA Sugar Consumption and Production, Exports, Imports 2005 (tonnes raw sugar)*

ESA Countries	Consumption	Production	Imports	Exports
Burundi	29,000	23,000	0	0
Comoros	9,000	-	7,556	0
Djibouti	16,000	-	15,561	0
Eritrea	20,000	-	65,493	45,000
Ethiopia	305,000	345,000	0	14,882
Kenya	756,141	531,540	181,783	21,760
Madagascar	131,548	27,300	116,631	8,852
Malawi	160,000	265,000	0	104,166
Mauritius	39,332	523,930	38,382	539,457
Rwanda	14,000	-	14,361	0
Sudan	876,688	727,781	200,000	122,609
Tanzania	267,856	278,496	86,226	20,149
Uganda	225,000	195,000	33,656	0
DRC-Zaire	95,000	60,000	35,000	0
Zambia	94,974	247,729	0	153,487
Zimbabwe	294,714	429,655	0	149,458
Total ESA	3,334,253	3,654,431	990,404	1,179,820

Source: Extracted from ISO Year Book for 2005

* No ISO Data is available for sugar consumption in the Seychelles

The ESA has some of the lowest cost sugar producers in the world with 4 ESA countries in the top 8 most cost effective sugar producers with production costs all below US \$ 360 per ton. However it also has some very high cost sugar producers. Many of the lowest cost producers are land locked and face significant cost disadvantages in getting sugar to overseas markets. All ESA exporters are facing the challenge of escalating freight charges, with shipping costs having tripled in four years. There are no indications that the burden of transportation costs will decline in the coming years. Indeed proportionately the burden of transportation costs will increase dramatically as EU sugar prices fall, with projected €/ \$ exchange rate movements compounding this problem and seeing a doubling of the burden of transportation costs from an average of 10% to 20% of the price received on the EU market by 2013.

The burden of transportation costs is likely to be compounded by the logistical challenge of securing the necessary shipping to deliver the raw sugar to the main cane refinery, given the limited draught along the Thames and the general movement over to larger vessels. This is likely to contribute to further increases in shipping costs over time.

In terms of the factors contributing to high costs of production these vary considerably across the region. In some instances it arises from the underlying agronomic conditions,

in others it can largely be put down to management inefficiencies and under-investment. In still others corruption and the general economic context is a constraining factor, while in some countries the social costs borne by the sugar industry account for a significant cost item. Regardless of the origin of the high costs faced, major efforts will be required to reduce costs to a minimum and open up new revenue streams from the sugar cane produced.

In some ESA countries major efforts have been successfully underway for many years, while in others a long path to competitiveness lies ahead, with many obstacles to be overcome. In all cases, for a wide variety of reasons, including not only the level of dependency on sales to the EU market, but also the regional knock-on effects of EU market changes and evolving sugar sector investment and trading patterns across the wider Southern and eastern African region, these efforts to **reduce costs, increase efficiency** and **open up new revenue streams** (including through value added processing) will need to be intensified.

The ESA region **producers far more sugar than it consumes**. This is particularly the case if we take the wider Southern and Eastern African region production and consumption into account (total net surplus of production over consumption 1.6 million tonnes). This is necessary of course since despite the division of the region into two configurations for the purpose of EPA negotiations, it remains a single economic region. This situation of sugar surplus will only increase in the coming years given the investment underway or planned in both the ESA and the wider Southern and Eastern African region, with the surplus likely to at double by 2014/15². This will serve to **increase the importance of the EU market to a far larger number of ESA producers, despite the scheduled decline in EU sugar prices**.

However this represents something of an anomaly, for as **EU prices fall** (particularly if a further round of price cuts is introduced in 2013), the **€ devalues against the US \$** and **freight charges continue to rise**, so the **significance of the price differential between the EU raw sugar price and world market raw sugar price will decline**, with under some scenarios the commercial significance of this price differential largely disappearing by 2015. Thus a situation will emerge where **in the short to medium term (up to 2013) the EU market will become more important**, but with the prospect that its **significance in terms of additional revenue earned will largely disappear in the long term** (beyond 2015) as EU raw sugar prices and world market raw sugar prices further converge³.

² This does not fully take into account the ambitious investment plans in Sudan and Ethiopia, which could see the surplus grow by much larger amount, if even half realized (see annex for details of projected expansion of exportable surplus).

³ See later section for more details.

This medium to long terms perspective needs to provide the basis for the development of the ESA regions sugar sector relations in the **short to medium** and **long term**.

- **EU Market Access Questions and Investment Flows**

Before the indication that the EC was planning to propose the introduction of duty free-quota free access for all ACP sugar producers (not only LDCs) within the frameworks of the EPA, investment flows in Southern and Eastern Africa (both within and beyond the ESA region) had been largely concentrated in least developed countries, with low costs of production. Here market access and production considerations had combined to offer a very favourable investment climate.

Indeed, since the announcement under the EBA initiative of the planned introduction of duty free/quota free access for LDC sugar exports from 2009, the issue of access to the EU market appears to have had a **profound impact on patterns of private investment in the sugar sector** in Southern and Eastern Africa. There was a major surge in private investment in sugar production in the least developed countries of Southern and Eastern Africa. In 2005/06 one major regional sugar company Illovo, announced plans to expand its sugar production outside of South Africa by 305,000 tonnes after 2010 at a cost of Rand 825 million. Further announcements were made in 2007, indicating additional increases in sugar production beyond this target, with all this coming on the back of the major expansion which had already taken place since 2000 (see Annex 2 for more details).

Tongaat-Hulett, the French major Terreos and a various Mauritian sugar interests were also involved in investments in least developed sugar producing countries in response to new market opportunities created by the introduction of the EU's Everything But Arms Initiative. In the case of Ethiopia largely government supported investment has seen sugar emerge as the ** most important export earner in trade with the EU.

Looking beyond the EU market, the Sudan is attracting investment in a major expansion of sugar production from Gulf sources, no doubt to serve newly established sugar refining capacity in the Gulf. This investment could see the Sudan emerge as the 'new Brazil', although this development may still be some years ahead, it could well come on stream when EU sugar prices reach their nadir and fundamental changes in the significance of the ESA-EU sugar sector relationship have occurred.

In contrast to the investment surge in sugar production in LDCs in the ESA region, until it became apparent the EU intended to extend duty free-quota free access to all ACP countries in the context of the EPAs, **there had been limited private sector investment flows into the development of additional sugar production in non-least developed sugar producers in Southern and Eastern Africa**. In Swaziland, which had continued to face quota restricted access to the EU market, the expansion of production was being driven almost exclusively by government investment in support of smallholder sugar schemes, rather than estate based production and out grower schemes financed by private companies. It has only been in recent months that Tongaat-Hulett announced plans to

expand sugar production in **Zimbabwe** from 240,000 tonnes to 442,000 tonnes and major private sector investment interest is emerging in Kenyan moves to privatize/modernize its sugar sector.

Thus until very recently the existence of the EBA initiative, in the context of continued quota restrictions on access for non-least developed ACP sugar exporters appears to have been profoundly affecting patterns of investment in the development of sugar production.

Thus one of the first impacts of the duty free-quota free offer to ACP sugar exporters under EPAs appears to have been to **level the playing field for investment location decisions**, with investment decisions now being made more on the basis of **the underlying costs of production and costs of transportation to market than the extent of preferential access being granted to the EU market.**

In the ESA region this will largely affect Zimbabwe and Kenya, particularly with regard to the Kenyan efforts to restructure and modernize its milling sector. However, given the way the EC currently plans to apply the transitional safeguard arrangement, this newly acquired investment attractiveness of non-LDC ESA countries is unlikely to adversely affect investment flows into LDCs, particularly the larger LDCs, with potentially strong domestic growth in sugar consumption.

An Investors View

“...because we will be able to supply duty free into the European union and that does give us a good basis for expansion projects because it is not that often that you get a good opportunity to expand your business against known prices....by 2009 in respect of the lesser developed countries in which four of our operations work, that is Malawi, Mozambique, Tanzania and Zambia will have duty free access and therefore we would be able to supply whatever tonnage we make into the European Union at a particular laid down price which is the bulk price. But we are hoping to be able to add value to that by producing specials or refining the sugar, so that we can in fact, share in the value chain within the European Union as well.”

Don Macleod, Chief Executive Officer, Illovo, November 17th 2006

3. THE REFORM OF THE EU SUGAR REGIME

- The Direction and Principal Impact of Reform

After considerable delay, with proposals for reform having first been developed in 1993, the reform of the EU sugar sector is now rather uncertainly underway. This reform essentially involves a move **away from very high price support for sugar** (i.e. via administratively setting the price of sugar beet and associated prices) to a **mixed system involving the inclusion of sugar production in the single payment scheme for farmers and the maintenance of administratively determined prices** (a move to high prices rather than very high prices). This process of administratively reducing prices is to take place over a four year period.

The reference price for white sugar will be reduced to €631.9 per tonne in 2006/07 and 2007/08, be further reduced to €541.5 per tonne in 2008/09 and to €405.4 per tonne in 2009/10. The raw sugar reference price will be similarly reduced, to €496.8 in 2006/07 and 2007/08, to €448.8 per tonne in 2008/09 and will finally fall to €335.2 per tonne in 2009/10. **This process of price reductions represents one of the main affects on ESA sugar exporters.**

This process of price reductions will be supported by the inclusion of sugar production in the **single farm payment** scheme and the mobilisation of some €8 billion in restructuring support, which will be used to finance the ‘voluntary’ relinquishing of sugar production quotas by EU millers. Given the difficulties faced in implementing the initial reform programme on May 7th 2007 a programme of supplementary support measures were announced design to encourage more millers to ‘voluntarily’ give up sugar production quotas. This included:

- fixing the restructuring payments farmers and contractors could receive at 10% of the amount (€62.5 out of €625/tonne);
- supplementing the payment to farmers with an additional payment of €237.5 (bringing the total to €300 per tonne and to be retroactively applied);
- allowing growers to apply directly for restructuring support and directly renounce quotas;
- providing additional incentives to processors to give up quota by waiving certain restructuring levy payment obligations.

- **Complicating Factors: Problems of Implementation**

The implementation of EU sugar sector reform is facing difficulties, with insufficient sugar quota's being voluntarily relinquished to meet the target for the reduction of EU sugar production (1.8 million tonnes offered against the background of a need for 5 million tonnes to be relinquished). In November 2006 Agricultural Commissioner Fischer Boel warned the EU sugar industry that the EC will not “*bail out the industry*” which must take up its responsibilities. She said EU “*Sugar producers which are not competitive should get out now for their own benefit as well as for the overall balance of the market*”⁴ She warned that if the industry did not take up its responsibilities compulsory linear quota cuts would need to be introduced. In this context on January 29th 2007 the European Commission announced initial steps were being taken for a compulsory quota cut of 2 million tonnes, in order to avert a surplus of sugar on the EU market. A final decision on the level of the quota cut will be taken in October 2007.

⁴ See EC press release (IP/06/1591-21/11/2006)

<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/1591&format=HTML&aged=0&language=EN&guiLanguage=en>

The EU reforms and the difficulties currently faced in their implementation provide one dimension of the context against which the implications of the EC's April 4th 2007 duty free-quota free market access offer need to be considered. **These difficulties would appear to limit the flexibilities the European Commission has in negotiating around sugar issue at this time.** Negotiating favourable terms of access to the EU market for the transitional period will be complicated by the political sensitivity of the sugar issue in the EU. These political sensitivities will need to be borne in mind in the **conduct** of negotiations on the management of transitional arrangements but should not be allowed to impinge on the overall objectives sought.

Trade Aspects of the Reformed EU Sugar Regime

The EU will retain in place both import duties and export refunds. In order to monitor the trade in sugar a system of import and export licenses will be retained. This will include a system for regulating and where necessary, prohibiting inward processing arrangements. The EC also retains the right to adopt safeguard measures should a threat of market disruption arise.

During the transition period import licenses are to be retained for the exclusive use of full time refiners. This situation will last until after the first three month of the 2009/10 marketing year. This implies that after the first three months of the 2009/10 marketing season import licenses will be open to other operators. This is understood to be the European Commission's intention. This will open up new "routes to market" for ACP sugar suppliers.

- Complicating Factor: the Globalisation of the EU Sugar Industry

The second major dimension of the context against which the implications of the EC's market access offer needs to be assessed is provided by **the investment and restructuring response of European sugar companies to the reform of the EU sugar regime.**

EU sugar companies in response to the announcement of the reforms are busy **restructuring, diversifying and going global** in their production and trading operations. The most notable development in this regard of relevance to the ESA regime is the acquisition by Associated British Foods (ABF) of a 51% share in the South African based regional sugar giant Illovo. This places **% of the Zambian sugar sector, and **% the Malawian sugar sector and ..% of the Tanzanian sugar sector in the hands of ABF⁵, the owners of both **British Sugar** (the major sugar supplier to the UK market and a major player in the Polish sugar sector) and **Billington's**, the leading supplier of **unrefined cane sugar** (including organic cane sugar and fair trade sugar) to the UK market.

Illovo however is unlikely to be the only regional sugar company linking up with a European partner, with Tongaat-Hulett reportedly seeking a European partner to facilitate its access to an evolving EU market. This has direct implications for the Zimbabwean sugar sector, given Tongaat-Hulett's purchase of the Triangle Estates in Zimbabwe.

⁵ As well as some 33% of the Swazi sugar sector, ..% of the South African sugar sector and ..% of the Mozambican sugar sector.

The EU Reform Measures

In November 2005 the following specific sugar sector reform measures were introduced:

- 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 quotas, with the aim of encouraging 'less competitive producers to leave the industry' (with payments being made of €730 per tonne in the first two years, falling to €625 in year three and €520 in year four) and the financing of social and environmental adjustment costs in the most affected regions to support diversification;
- 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)⁶;
- 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 quota is renounced';
- the merging of the 'A' and 'B' quotas;
- a provision for the use of non-quota sugar in the domestic 'chemical and pharmaceutical industries and for the production of bio-ethanol';
- the maintenance of the intervention agency 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 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';
- an increase in the isoglucose quota of 300,000 tonnes for existing companies, phased-in over three years;
- the possible purchase by Italy (60,000 tonnes), Sweden (35,000 tonnes) and Lithuania (8,000 tonnes) of extra isoglucose quota at the restructuring aid price.

The new sugar regime came into force on July 1st 2006, with the first year of application running for 15 months, after which the sugar-marketing year will run from October to September.

⁶ This part of the reform package has been revised in light of the low take up of restructuring support. Payments to farmers are now to be financed out of the general CAP budget with the restructuring funds available to finance the voluntary relinquishing of quotas thereby being expanded.

Other European sugar companies also have holdings in the wider southern and eastern African region outside of the ESA configuration (e.g. Terreos' interests in Mozambique), while intra-regional investments by ESA based sugar companies are also underway, sometimes in association with non-EU investors. In a context where Kenya, Uganda, Sudan and Ethiopia are all looking to restructure existing sugar companies or invest in new sugar production and milling capacity, **the globalization of the EU sugar industry in response to the process of EU sugar sector reform constitutes an important dimension of the context in which future ESA-EU sugar sector relations will be developed.**

These developments will potentially have profound implications on how the ESA region markets its sugar into the EU. Given the way the EU market is to be opened up to increased competitive pressures, these developments could have **profound implications for the nature of the ESA-EU sugar trade and the wider pattern of development of the regional sugar sector.**

4. THE EC'S APRIL 4TH 2007 MARKET ACCESS OFFER

- The EC Offer on Sugar

The EC's April 4th 2007 ACP market access announcement, which proposed immediate duty free-quota free access for ACP exports under EPAs, except for sugar and rice, set out the transitional arrangements to be applied to sugar. For sugar a three phased transitional arrangement is envisaged:

- **Phase 1** (January 2008-October 2009): a continuation of the sugar protocol, with a substantial improvement of LDC market access for marketing year 2008/09; initial market access for ACP non-LDCs not party to the Sugar Protocol and additional market access for ACP non-LDCs party to the Sugar Protocol;
- **Phase 2** (October 2009 – October 2015: duty free and quota free access subject to an automatic safeguard clause applicable solely to non-LDC ACP sugar exporters, with up to September 2012 *“importers of ACP sugar ...required to pay not less than a certain price level”* and with after September 2012 *“ a price information system based upon the current system”* providing for *“transparency of the market”* ;
- **Phase 3** (October 2015 onwards) full duty free and quota free access to the EU market will be granted, *“subject to a special safeguard clause for sugar... based of the regular EPA safeguard clause, adjusted to take account of the sensitivity of sugar”*.

In addition from October 2009 a limited number of processed agricultural products with high sugar content would be subject to an enhanced surveillance mechanism in order to prevent circumvention of the sugar import regime. With regard to this aspect care will need to be taken to ensure that this provision is only applied where a clear attempt to circumvent import arrangements for sugar per se is apparent. It should not be applied to the sugar contained in other products, which form an integral part of these products (e.g. sugar in canned fruit). Assurances to this effect should be sought on the ESA-EU EPA negotiations.

- **Unanswered Questions in the EU Offer**

There is a lack of clarity in the EU offer on what is specifically meant by the various provisions. Questions arising include:

- How much additional market access for ACP non-LDCs will be granted up to 30/09/2009?
- How will this additional market access be distributed? (Will it be on a 'first come first served' basis or will there be quotas?)
- What will be the automatic volume threshold for the safeguard clause from October 2009?
- Will this automatic volume threshold be applied regionally or globally across the ACP?
- What is meant by the phrase "*a certain price level*" until September 2012?
- Does this phrase "*a certain price level*" mean there will be no guaranteed price for sugar exported to the EU from September 2012?
- How will the removal of the price guarantees of "*a certain price level*" from September 2012 interact with the EC decision to limit the retention of import licenses to full time refiners only until after the first three months of the 2009/10 marketing year in terms of the effects on the prices offered for ACP sugar?

Clearly these uncertainties will need to be addressed if a proper evaluation of the EC April 4th market access offer on sugar is to be evaluated.

- **Implications of the EU Offer: Prospects for Future EU Reductions**

However, there is another important implication of the structure of the EC 4th April market access offer which needs to be taken on board, namely **the implication for the treatment of sugar under the 2013 CAP review**.

At current rates of exchange between the Euro and the US \$⁷ the post reform EU sugar price will yield a price of 20.74 c/lb. This compares to a world market price in August 2007 of 9.27 c/lb. This represents a price differential between EU and world market prices of 11.47 c/lb, with EU prices at current exchange rates and world market prices more than twice the world market price of sugar.

⁷ At an exchange rate of €1 to US \$ 1.3622 (August 15th 2007 rate).

Factors Driving a Further Round of EU Sugar Price Reductions

There are five major factors suggesting there will be a further round of EU sugar price reductions in 2013:

- **The Experience in Other Arable Sectors:**
In the cereals sector, prices were reduced in two major phases (1992 and 2000) to around 50% of the pre-reform level, despite the strength of the Euro against the US \$, with rising world market prices, EU producers are now in a position to escape WTO limits on exports and a major expansion of EU wheat exports is projected up to 2013. Similarly in the rice sector, after a 50% price reduction, and a shift to direct aid payments and assistance in diversifying into higher value rice varieties, in the first post reform year, EU production actually increased.
- **The Implications of the Commitment to the Abolition of Export Refunds:**
With EU sugar price twice the world market price, this would place food products using sugar as a major input at a major disadvantage on export markets. While the EU could expand MFN import quotas and the use of non-quota sugar for industrial uses to include food products, this would greatly complicate the administration of the regime at a time when the EC is aiming for administrative simplicity
- **The Administrative Difficulties of a Two Tier Pricing System**
Already a two priced market has emerged in the EU, with quota sugar and ACP/LDC exports receiving the administratively determined price and MFN and non-quota sugar receiving prices based on world market prices. Currently these sugars serve different components of the EU market, with the latter serving the non-food industrial market. Any expansion of this two tier pricing system would be complex and lay itself open to extensive abuse. The EC is thus likely to be disinclined to support the expansion of such a system
- **The Structure of the April 4th 2007 EC Market Access Offer:**
The three phased offer tabled by the EC grants full duty free-quota free access by 2015, this strongly implies that another round of sugar price cuts will be introduced in 2013 and phased in up to 2015.
- **The Logic of CAP Reform**
The basis objective of CAP reform is to shift assistance from price support to direct aid payments so as to allow EU prices to fall to around world market price levels and to shift European agricultural production to higher quality forms of produce so as to reduce competition from highly price competitive developing country suppliers. This policy thrust is designed to feed into an increasingly globally orientated EU food product industry. There is no basis for sugar being an exception to this basic thrust.

In this context and given the broader CAP policy objective of bringing EU prices down much closer to the world market levels, there would appear to be a need for a **further round of EU sugar sector reforms in 2013**. Indeed, this would appear to be implicit in the structure of the EC's April 4th 2007 market access offer, where full duty free quota free access would only be offered ACP after October 2015 (i.e. after two years implementation of further reform measures).

Elsewhere in arable sectors subject to CAP reform the eventual level of floor prices established under the reform measures implemented have been approximately half of the pre-reform level. This would appear to suggest that the **EC plans to use the 2013 reform of the CAP to further reduce the EU sugar price, perhaps to as low as half of the pre-reform price level some, €261.85 per tonne**

While at current Euro/US \$ exchange rates this would still deliver a sugar price of 16.21 c/lb it needs to be borne in mind that the February 2007 European Commission report on future prospects for EU agricultural markets and incomes was compiled on the basis of the assumption of a US \$/€ exchange rate of 1.15 to 1⁸. Such an exchange rate would yield an EU fob sugar price of only 13.69 c/lb by 2015, if a further round of price reductions took place in line with the pattern of reform in other arable sectors. This would be a price little different from the projected longer term price range for world market sugar (between 10 and 12 c/lb cif), since this price needs to cover insurance and shipping freight charges and world market prices are cited free on board .

In should be stressed that this is only one possible scenario. However it is consistent with the overall trajectory for CAP reform, into which the EU sugar sector is increasingly being integrated.

This provides the background against the EC decision to denounce the sugar protocol needs to be seen and the EC assurance that this is “*part of the process of the EU enhancing its market access for ACP countries in the context of EPAs*”, needs to be viewed.

5. RENUNCIATION OF THE SUGAR PROTOCOL

- April 4th Offer: Laying the Basis for Renunciation

The EC’s April 4th offer was designed to lay the basis for the renunciation of the sugar protocol, in terms of the public presentation of the EC proposal. This has been acknowledged by EC officials⁹. However, **the underlying imperative for renunciation of the sugar protocol was effectively laid through the EU sugar sector reforms and the wider process of CAP reforms.**

Across various sectors the EC wishes to move away from **quota based systems of production management**. This is inherent in the logic of the establishment of the single farm payment scheme which is designed to insulate new forms of EU agricultural support

⁸ An exchange rate scenario also used in the July 2007 update.

⁹ In the August 1st EC note of the July 23rd debriefing on the sugar protocol with ACP Ambassadors, it was clearly stated “*when the COMM presented its DFQF offer, it was clear that the end of the sugar protocol was 30 September 2009*”.

from WTO challenge, by bringing **all** CAP covered agricultural products into a **single farm payment scheme**. On this basis the EC can argue that since such support is **non-product specific** and is **not connected to any given level of production**, it falls within the ‘green box’ and thus cannot be subject to negotiated reduction commitments or challenge through the WTO dispute settlement mechanism. However the establishment of such a scheme requires the **abandonment of production quotas as a management tool**. In this context the Agricultural Commissioner Marianne Fischer Boel has repeatedly made it clear that the EC is committed to the abolition of production quotas in the dairy sector from 2015, when this policy tool is scheduled for review. Production quotas have been central to the management of the EU dairy sector to date and their removal would de facto signal the death knell of quotas as a management tool within the CAP – **the abolition of sugar production quotas within the EU would inevitably follow**.

In this context the EC could scarcely contemplate continuing country specific quotas as a management tool for regulating imports. This leaves the EC with little option but to grant duty free quota free access as the basis for future ACP-EU trade relations. The only questions were:

- a) **from when would such duty free quota free access be granted?**
- b) **how would such duty free-quota free access be managed during the transitional period during which time the process of EU sugar sector reform was being completed?**

A critical issue during the transitional period will be the use of the safeguard mechanism. Formerly within a quota managed system ACP sugar exports were not subject to any safeguard measures. Under the new arrangement this immunity from safeguard measures will be removed for non-least developed sugar exporters. It would appear to be necessary during the transitional period, while the EU is more likely to have recourse to safeguard measures, to ensure a minimum level of market access for non-LDC sugar suppliers (above current levels of sugar exports for each country) within the duty free-quota free offer. This however may require the EU to maintain a certain level of intervention buying for ACP sugar during the transition period up to the elimination of safeguard measures in 2015.

This of course would run foul of the EU commitment to dismantling intervention buying following the transition. Currently the system of intervention buying in the sugar sector will only be retained during the four-year transition period. This will be replaced by *“the introduction of a private storage system as a safety net in case the market price falls below the reference price”*. Effectively this involves the dismantling of intervention buying of sugar by the EU, i.e. the ending of the role of the EU as the buyer of last resort of internally produced sugar.

In this context the EC could scarcely maintain its role as a buyer of last resort for ACP sugar under the terms of the sugar protocol. This aspect of the EU reform package

created an imperative for the EU to escape the obligations incumbent upon it under the protocol with regard to the role of EU intervention agencies as ‘buyers of last resort’ for ACP sugar protocol exports. The prospect of increased volumes of LDC sugar exports under the EBA or non-LDC sugar exports under the 4th April market access offer, was largely a secondary consideration (since such large volumes of exports are not expected under the new market conditions to be created by the overall process of sugar sector reform). The primary factor requiring the abandonment of the EU’s commitment to being a ‘buying of last resort’ for ACP sugar lies in **the abandonment of such a role within the EU itself and the dismantling of the institutional arrangements for the performance of such a role.**

The final key benefit of the sugar protocol which is to be abandoned relates to the price guarantees. Here again the basis for the abandonment of the price guarantees enshrined in the sugar protocol was laid down in the EU sugar reform package, with the April 4th 2007 market access offer simply formalizing this position. The sugar sector reforms, in line with the broader process of CAP reforms, are seeking to bring EU sugar prices closer to world market price levels. The **ultimate aim is to establish a floor price for sugar, which will allow EU market prices to be determined by price trends on the world sugar market**¹⁰. This has clear implications in two areas:

- a) the need to let sugar prices offered for ACP sugar be determined increasingly by the market prices in the EU, rather than negotiations within a pre-determine set price range;
- b) the prospects for future administratively determined prices in the EU under the 2013 round of reforms.

It is against this background that the provisions of the April 4th market access offer dealing with prices need to be seen.

These provisions envisage requiring importers of ACP sugar to “*pay not less than a certain price level*” up to September 2012. After September 2012 “*a price information system based upon the current system*” providing for “*transparency of the market*”, will be set up to help determine prices to be negotiated commercially between importers and exporters. This is the **logical extension of the fundamental EU policy objectives of moving EU agricultural prices closer to world market price levels, so that ultimately they will be determined by prevailing world market price levels.**

If price guarantees for EU farmers are being abandoned, with prices increasingly being determined by the market, the EC can scarcely sustain price guarantees for ACP sugar suppliers which are unrelated to market trends. Hence the need to abandon any pretence of price guarantees under the sugar protocol.

¹⁰ A situation which has recently been achieved in the dairy and cereals sector, where rising world market prices, despite the weakness of the US \$ against the Euro/Pound, has allowed the EU to set export refunds at zero and is increasingly seeing EU prices move with world market prices, rather than being determined by the administratively determined floor price.

However, as in other areas, **this evolution in EU policy does not have its roots in the April 4th market access offer or even the planned denunciation of the sugar protocol**, but rather is **an extension of the underlying process of CAP reform**, which in other agricultural sectors has been underway since 1992 and which has been underway in the sugar sector since 2006. Within this process of reform security of income for EU farmers (and hence the maintenance of production) will of course increasingly be guaranteed by the **single farm payment**, rather than price guarantees on the EU market. In this context the question arises: **how can the security of income for ESA sugar farmers be guaranteed and hence production maintained?**

- **Wider Processes of Market Change**

The process EU agricultural reform needs to be seen against the background of efforts underway in the EU to shift patterns of agricultural production in the EU away from serving '*necessity purchase*' components of the EU market to serving '*luxury purchase*' components. Responding to these market changes forms an integral part of the EU strategy for reform. **They will also need to form an integral part of the ESA response strategy**, for certain countries an certain sub-sectors of the sugar industry.

These developments are **creating a fundamentally different market reality for ACP sugar which will have profound implications for the future development of the sugar sector in the ESA region**. It is to this which we now turn

**Evolving EU Markets:
The "Luxury Purchase"- "Necessity Purchase" Division and its Implications**

There are now two distinct components to the EU market – "**necessity purchases**" and "**luxury purchases**". "Necessity purchases" are those products where purchase decisions are made exclusively on the basis of price considerations. For "luxury purchases", in contrast, purchase decisions are not primarily based on price, but on some perceived "quality" attributes of the product. It might be organic, or artisanale produced, or it might be a "fair trade" product or respect animal welfare standards, or have some particular geographical designation of origin to which a particular value is attributed or it might be a combination of quality/convenience characteristics of the product which makes consumers willing to pay more. Whatever the non-price reasons which drive the purchase decisions, this type of EU consumer is willing to pay more for the "luxury purchase" product compared to the "necessity purchase" product.

Significantly, there are now two distinctly divergent price trends on EU markets, with stagnant demand and increasing trade liberalization prices of "necessity purchase" products are declining, with restricted supply and growing demand prices of "luxury purchase" products are rising.

Against this background a conscious effort is being made within the process of EU CAP reform to shift patterns of European food and agricultural production towards serving this "luxury purchase" component of the EU market. This is a central tenant of agricultural reform in the EU as it progresses into the 21st century. The opposite side of this coin will be an increased EU openness to the import of basic agricultural raw materials and food products serving the "necessity purchase" component of the EU market, since EU producers will be less and less concerned about this component of the market. However, this openness will occur against a backdrop of declining prices for these "necessity purchase" products on the EU market.

6. ADDRESSING A FUNDAMENTALLY DIFFERENT MARKET SITUATION

- The Nature of the Fundamental Market Changes Underway

The process of EU sugar sector reform and the renunciation of the sugar protocol will fundamentally transform the market situation facing ACP sugar supplies. Formerly ACP sugar suppliers benefited from

- country specific quotas and immunity from safeguard measures;
- a high guaranteed price for the raw sugar supplied to a pre-determined set of processors;
- recourse to a buyer of last resort (EU intervention agencies), if no commercial buyer for their sugar could be found in the EU at the guaranteed price.

Under the post reform, post-sugar protocol arrangement the following situation will prevail:

- no country quotas will be allocated, but rather duty free-quota free access will be allowed (within safeguard ceilings) within a framework which envisages imports from ACP/LDC countries of up to 3.5 million tons, in a context of a finite level of dedicated cane sugar refining capacity and declining prices;
- the high guaranteed price will be reduced by at least 36%, with the possibility of further price cuts between 2013 and 2015 being introduced;
- the role of the EU intervention agencies as buyers of last resort will be abolished;
- new avenues to the EU market for ACP produced sugar will be opened up.

This will create a situation of increased competition between raw cane sugar suppliers on the EU market in a context of: a substantial decline in EU sugar prices; rapidly escalating freight costs (freight charges have tripled in the last four years); finite dedicated cane sugar refining capacity; uncertain location and possible supplementary freight charges on supplies to former beet refiners.

This will fundamentally change the economics of ACP cane sugar trade with the EU. It is this reality and its implications which has not yet been addressed in the various assurances from the EC with regard to **safeguarding** and **preserving** the benefits of the sugar protocol, through its April 4th market access offer. The EC places considerable emphasis on the maintenance of preferential treatment on the EU market, which it holds is the most important part of the protocol.

However, the most important part of the sugar protocol relates **not to the preferential access per se**, but to the **value of the preferential access granted**. This is being **fundamentally undermined by the process of sugar sector reform**, in line with the mainstream of CAP reform. This is reducing income on sugar exports to the EU by 36% over the four year period up to the 2009/10 season. This will fundamentally affect the ability of ESA sugar suppliers to profitably export sugar to the EU market, particularly if under the 2013 round of CAP reforms, further reductions in the EU sugar price occur (see earlier section for details). Such a further round of CAP Reform would appear essential if the sugar sector is to be brought fully into line with other EU arable crops which form part of the single payment scheme.

- The Wider Impact of EU Sugar Sector Reforms

However, as the table below illustrates, **sugar protocol beneficiaries beyond the ESA region are likely to be more severely affected** by the process of EU prices reductions than ESA countries, given their underlying cost structure.

Non-ESA Sugar Protocol Beneficiaries: Costs of Production and Transport after restructuring to lower costs (2009)

Country	Prod Cost €/t	Transport Costs (€/t)	Total Cost (€/t)	Pre-reform EU price (€/t)	EU price 2010 (€/t)	Possible 2015 price (€/t)
Swaziland	176	76	252	523.7	335.00	261.85
Mozambique	141	68	209	523.7	335.00	261.85
Congo	229	104	333	523.7	335.00	261.85
Cote d'Ivoire	264	112	376	523.7	335.00	261.85
Barbados	352	60	412	523.7	335.00	261.85
Belize	211	92	303	523.7	335.00	261.85
Guyana	211	76	287	523.7	335.00	261.85
Jamaica	264	56	320	523.7	335.00	261.85
St Kitts	440	80	520	523.7	335.00	261.85
Trinidad	440	80	520	523.7	335.00	261.85
Fiji	229	80	309	523.7	335.00	261.85

Source: Extrapolated from Table 8 of the Draft Report "Safeguarding the benefits of the ACP-EU Sugar Protocol in the context of the EPA negotiations" (20/02/07)

As can be seen from the above, **St Kitts and Nevis** and **Trinidad and Tobago** are exiting the EU sugar market even at current prices (removing slightly under 72,000 tons of sugar from ACP supplies to the EU market). With the implementation of the planned price reductions by 2009/10 continued sugar exports would be clearly unprofitable for the non-ESA sugar protocol suppliers **Ivory Coast, Barbados**, and probably unprofitable for **Congo, Jamaica** (removing over 237,135 tons of sugar from the EU market). This is of course unless major additional cost savings can be made and significant new revenue streams can be opened up from sugar cane production. Extensive efforts are of course underway in both of these areas, particularly in the Caribbean.

If as is feared, as part of the 2013 round of CAP reforms, the EC introduces a further round of sugar price reductions, comparable to those introduced in other arable sectors (i.e. bringing EU prices down to 50% of the pre-reform level) then the future of sugar exports to the EU from the wider ACP region would be further affected with Guyana and Fiji being the principal losers in the wider ACP region.

However, balancing this is the planned expansion of sugar production and exports to the EU market largely from least developed countries from the wider Southern and eastern African region (but not exclusively from this region), which seems likely to bring a minimum of an additional 800,000 tons of sugar supply on stream by 2011 and substantially more by 2014/15, even if only part of the ambitious Sudanese and Ethiopia production plans area realised. In addition the opening of market access to a non-LDC non-sugar protocol supplier (Dominican Republic) under the April 4th market access offer will also increase sugar supplies to the EU market.

This provides the overall context within which the impact of the EC's April 4th duty free-quota free market access offer needs to be assessed and an appropriate policy response in the ESA framework formulated.

7. IMPLICATIONS OF THE EU SUGAR SECTOR REFORMS FOR THE ESA REGION

- The Price Implications of the EU Sugar Sector Reform Measures

The process of EU sugar sector reform will have direct consequences for the price received by ACP/LDC sugar exporters. In 2006/07 the sugar price paid to sugar protocol exporters was reduced from €523.7 / tonne to €496.8/ tonne. This 5.1% reduction was equivalent to the processing aid formerly paid to EU sugar cane refiners. LDC producers exporting under the EBA were not affected by this change since no processing aid was granted EU refiners on these sugar imports. The first major price cut affecting EBA sugar suppliers will take place in 2008/09 when the price paid, €448.8 / tonne will be 16.7% below the pre-reform price. A final price cut in this round of reform will take place in 2009/10, when the price paid ACP sugar suppliers will fall to €335.0 / tonne, 36% below the pre-reform price.

Changes in prices for ACP raw sugar

Year	Price per tonne	% change (cumulative)
Current regime	€523.7	0
2006/07	€496.8	- 5.1%
2007/08	€496.8	- 5.1%
2008/09	€448.8	-16.7%
2009/10	€335.0	-36.0%

This will have a direct impact on the earnings of ESA countries exporting sugar to the EU under the **sugar protocol**, the **complementary quantities** arrangement and the **EBA initiative**.

ESA least developed countries exporting under the Everything But Arms initiative (EBA) and those non-least developed countries exporting additional tonnages under the **complementary quotas** will lose €48 per tonne on the sugar exported in 2008/09 compared to the price received up to that date and €161.8 per tonne on sugar exported in 2009/10 and successive years compared to the price currently received. The principal countries affected under the EBA will be **Ethiopia, Sudan, DRC, Malawi, Tanzania and Zambia** (with the last three countries also losing out the complementary quotas arrangement), while **Zimbabwe** will be the principal losers under the complementary quantities arrangement.

Losses by ESA sugar-protocol beneficiary countries

	Sugar-protocol quota (tonnes raw sugar equivalent)	Current earnings (€)	Earnings 2006-08 (€)	Earnings 2008/09 (€)	Earnings 2009/10 and after (€)
Kenya	10,000.0	5,237,000	4,968,000	4,488,000	3,350,000
Madagascar	11,695.7	6,125,013	5,810,400	5,249,030	3,918,043
Malawi	22,635.2	11,854,063	11,245,176	10,158,677	7,582,798
Mauritius	533,728.3	279,513,490	265,156,200	239,537,261	178,798,967
Zambia	10,000.0	5,237,000	4,968,000	4,488,000	3,350,000
Zimbabwe	32,853.0	17,205,139	16,321,392	14,744,426	11,005,770

Thus the benefits of unlimited access which least developed countries will enjoy will in part be undermined by the price reductions which will occur over the period of reform. This being said the investment which is taking place in least developed countries sugar sectors in the ESA region (see later section for details), in response to the unlimited access to the EU market to be granted from 2009, in the context of a guaranteed price of around 19c/lb¹¹, is **more than offsetting the price reduction effects at the national level** (although at the level of farmers, the EU price reductions could adversely affect the price paid for sucrose), since LDCs have traditionally exported only limited volumes of raw sugar to the EU market¹².

ESA LDC Exports Under the EBA (2001/02 to 2005/06 – tones white sugar equivalent)

Country	2001/02	2002/03	2003/04	2004/05	2005/06
DRC	-	-	-	11,670.9	7,037.6
Ethiopia	14,298.0	14,689.3	15,248.7	13,796.9	13,669.5
Malawi	10,402.2	10,661.3	10,959.4	27,603.4	27,579.8
Sudan	16,256.7	17,036.8	16,978.7	16,358.4	14,250.0
Tanzania	9,065.4	9,317.2	9,940.3	1,668.1	7,574.8
Zambia	8,758.0	9,016.7	9,538.4	9,180.5	15,671.0
ESA Total & % share total EBA exports	58,780.3 79.2%	60,721.3 71.2%	62,665.5 63.9%	63,919.8 56.7%	85,782.7 66.1%

¹¹ At Euro/US\$ exchange rates of around €1 to US \$ 1.30.

¹² ESA LDCs enjoyed only 132,034 tonnes of preferential access to the EU market in 2005/06 (the final year before the implementation of EU sugar sector reforms) under the sugar protocol, SPS arrangement and EBA initiative. This contrasts with a total sugar production in 2005 of 1,864,006 tonnes. Thus the EU market took only 7.1% of these countries total sugar production (these figures exclude total DRC sugar production for which no ISO figures are available). This was up from a mere 84,816 tonnes in 2001/02 when total sugar production of 1,543,109 tonnes (a mere 5.5% of total ESA LDC production in 2001).

Needless to say the process of price reductions underway will also reduce the value of any duty free quota free access granted non-least developed ACP sugar suppliers under the EU's April 4th 2007 market access offer.

- Underlying Cost Issues

The significance of these price reductions in individual ESA countries will be determined by the underlying cost structures of the individual industries and producers within the industries and the extent to which investment takes place in developing new revenue streams from sugar cane production and making more effective use of by products in reducing underlying production and milling costs. According to figures contained in the Thornhill report on safeguarding the benefits of the sugar protocol, ESA countries exporting under the sugar protocol have the following cost structures¹³:

Costs of Production and Transport in Sugar Protocol Beneficiaries

Country	Prod Cost (€/t) 2009	Transport Costs (€/t) 2009	Total Cost (€/t) 2009	Pre-reform EU price (€/t)	EU price 2010 (€/t)	Possible 2015 price (€/t)
Kenya	264	120	384	523.7	335.00	261.85
Madagascar	317	80	397	523.7	335.00	261.85
Malawi	141	92	233	523.7	335.00	261.85
Mauritius	229	64	293	523.7	335.00	261.85
Zambia	141	116	257	523.7	335.00	261.85
Zimbabwe	158	84	242	523.7	335.00	261.85
Tanzania	211	120	331	523.7	335.00	261.85

Source: Extrapolated from Table 8 of the Draft Report "Safeguarding the benefits of the ACP-EU Sugar Protocol in the context of the EPA negotiations" (20/02/07)

On the basis of the cost structure outlined in the Thornhill report, **Kenya** and **Madagascar**¹⁴ face major challenges in profitably supplying the EU market at the 2009/10 price, with major cost saving being required if profitable exports to the EU are to take place¹⁵. According to Kenyan sugar industry observers, considerable cost savings could be made in Kenya, through successful institutional and managerial reforms. However the problems faced in this regard appear to be deeply engrained, with major challenges being faced. However, the direct consequences for the Kenyan sugar sector would appear to be small, given the tiny proportion of total Kenyan sugar production (around 2%) destined for export to the EU market. Of more significance to Kenyan will be the knock-on effects of EU sugar sector reforms on regional sugar trade flows and regional sugar prices. **Tanzania** could also face difficulties in profitably exporting given its envisaged cost structure, although further costs savings would appear to be possible in the Tanzanian sugar sector as investments take place and management improvements

¹³ This report does not provide data on the costs of production in Ethiopia and Sudan. If other sources were used there would be no certainty that the data used in assessing costs was comparable. Against this background it is simply assumed that the costs of production of Ethiopia and Sudan are similar to those of Malawi and Zambia, while costs of production for Uganda are assumed to be comparable to Tanzania with transport costs comparable to Zambia i.e. production costs (€211/ton) and transportation costs (€116/ton) giving total costs for Uganda of €327/ton

¹⁴ Uganda which does not currently export to the EU would appear to be in a similar position to these two countries in terms of their future export prospects.

¹⁵ Madagascar does not currently export sugar to the EU..

continue. In addition there would appear to be scope for opening up **new revenue streams** from sugar cane production. Such further innovations could help Tanzania to continue to profitably supply the EU market. This seems a likely scenario given the recent pattern of corporate investment in the Tanzanian sugar sector. Other ESA sugar exporters would appear to be able to export profitably at the post reform 2009/10 price of €335/ton.

- **The Implications of a Possible 2013 Round of Sugar Price Reductions**

The issue of opening up **other revenue streams** from cane production and more effectively **exploiting cane by-products to reduce costs** takes on particular significance under a scenario whereby a further round of EU sugar price reductions is introduced in 2013. Under such a scenario and current projected costs structures, in the absence of such innovations, would see **Mauritius** and probably **Zambia** unable to profitably export raw sugar to the EU. Of course, if in the interim other revenue streams from cane production had been opened up (sales of higher value alcohol or ethanol products, produced from molasses, co-generation of electricity from cane waste and baggasse), then the economics of supplying sugar to the EU market at the much lower price would be correspondingly transformed.

Without such innovation however, in the ESA region only **Malawi, Zimbabwe, Sudan** and possibly **Ethiopia** would be able to profitably supply the EU raw sugar market at a hypothetical post 2015 EU sugar price of half the pre-reform EU sugar price (261.85/tonne). In such a context the importance of cost effectively supporting innovations to open up **new revenue streams** and further reduce costs by fully exploiting sugar cane residues and by products cannot be under-estimated.

Already in response to the announcement of the existing EU policy changes, some sugar mills in the Southern and Eastern Africa have succeeded in eliminating coal purchases for electricity generation as a cost item. Others have opened up new revenue streams from alcohol production, with for some milling companies this generating up to a third of total profits. These elements are often being driven by private sector initiatives, but could benefit from public financial assistance, with, in exchange, the benefits of innovation being made available for more general use across national and regional sugar sectors.

The key policy issue confronting ESA governments in this regard is how to ensure **an equitable distribution of the benefits of these innovations through the production chain, particularly down to sugar cane farmers**. A particular role could be played by **public support to this process of innovation**, in order to ensure that in future **sugar cane farmers also benefit from cost savings or the new revenue streams opened up**.

However it should be noted, that under such a scenario, depending on the evolution of the US\$/Euro exchange rate and world market sugar prices, the world market could become a more attractive proposition than the EU market as a destination for such ESA sugar.

- **Implications of the Reform of the Import Licensing Arrangement**

A further issue which will need to be borne in mind is the implications of the EC decision to retain import licenses for the exclusive use of full time refiners **only until after the first three month of the 2009/10 marketing year**. This implies that after the first three months of the 2009/10 marketing season **import licenses will be open to other operators**. This is understood to be the European Commission's intention. While this will **open up new "routes to markets" in the EU for ACP sugar suppliers**, the full implications of this have not yet been fully assessed.

Presumably it will be possible to import increased volumes of direct consumption raw sugar, including those to serve '*luxury purchase*' components of the EU market (e.g. organic and fair trade markets), although exports trends in these areas will depend on the rate at which these markets can be grown. Serving these markets, significant market growth occur will probably be easier for those ESA countries where Illovo has a dominant, role given its corporate linkages via Associated British Foods to Billington, the principle marketer of direct purchase raw cane sugars in the UK. **The extent to which expansion of these '*luxury purchase*' exports will be possible, the investment required and the potential sources of such investment**, will all need to be carefully explored in the coming years by ESA governments and industry associations.

This opening up of import licensing arrangements may well be an issue which ESA governments would wish to include in the current EPA negotiations, in order to ensure that licensing arrangements **do not systematically discriminate against ESA operators with no corporate linkages directly into the EU market**¹⁶.

This development with regard to licensing arrangements needs to be seen against the backdrop of EC projections of increased imports of sugar to the EU market. In February 2007 for the first time the EC included sugar in the annual survey of "Prospects for Agricultural Markets and Income". This document sought to project the likely evolution of the EU's production and trade situation in the sugar sector following on from the implementation of the agreed sugar sector reforms. It projected imports of sugar to rise from 3.0 million tonnes in 2005 to 3.8 million tonnes in 2007, to 4.2 million tonnes by 2009 and 4.4 million tonnes from 2010 onwards¹⁷. Within these imports the EC is envisaging a total 3.5 million tonnes of sugar originating in the ACP/LDC group¹⁸ combined, with non-LDC (former) sugar protocol suppliers exporting 1.3 million tonnes and LDC sugar suppliers exporting 2.2 million tonnes.

Given the finite dedicated cane sugar refining capacity in the EU and the emergence of new importers (and non-ACP exporters, notably Cambodia), the questions arise:

¹⁶ An issue potentially of greatest interest to Sudan and Ethiopia, given the current sources of investment in sugar expansion in these countries.

¹⁷ These projections were broadly reiterated in the EC's July 2007 update of prospects for EU agricultural markets and incomes, except for a reduction in projected imports of 100,000 tonnes in both 2008 and 2009..

¹⁸ It should be borne in mind that the LDC Group potentially includes some non ACP suppliers, with Thai investment in sugar production in Cambodia, being a particular source of potential competition for ACP LDC suppliers.

- **what will be the market impact of increased supplies and the emergence of new importers?**
- **will this strengthen the market position of ESA suppliers from 2010 onwards or will it weaken the market position of ESA suppliers?**

This is a critical issue which needs more detailed investigation in the context of the implications of the **renunciation** of the sugar protocol and the associated commitments on price and 'purchase into intervention' which this will entail .

EU Sugar market projections 2003-2013 (EU-27) (million tonnes)

Year	Net. Production	Net Consumption		Imports	Exports
		Total	Bio-fuels		
2004	19.6	16.1	0.0	3.2	4.9
2005	20.3	17.0	0.0	3.0	6.7
2006	17.4	17.4	1.0	3.0	1.3
2007	16.1	18.6	1.1	3.4	1.3
2008	16.4	19.2	1.3	4.1	1.3
2009	16.6	19.4	1.4	4.2	1.3
2010	16.8	19.8	1.6	4.4	1.3
2011	16.7	20.1	1.8	4.4	1.3
2012	15.2	20.5	2.0	4.4	0.9
2013	15.7	20.8	2.2	4.4	0.7
2014	15.6	20.9	2.2	4.4	0.3

Source: Extracted from table A.8, "Prospects for Agricultural Markets and Income 2007-2014", European Commission Directorate General for Agriculture, July 2007. <http://ec.europa.eu/agriculture/publi/caprep/prospects2007a/fullrep.pdf>

- **Regional Knock-On Effects of EU Sugar Sector Reforms**

A further indirect impact of the agreed EU sugar-sector reforms relates to its impact on the functioning of regional sugar markets in the ACP, particularly in a major sugar surplus region such as the Eastern and Southern African region. Currently the ESA region produces 3,654,431 tonnes of sugar, exports over 832,000 tonnes of sugar to the EU market (and 1,179,820 tonnes in total in 2005). With EU sugar prices set to fall by 36% and freight charges on shipments to the EU having risen three fold in the last five years, the EU market will be **less attractively priced** than a number of neighbouring regional markets, most notably in an ESA context, the Kenyan market, but also the Zambian market. In this context the questions arise:

- **what will be the knock-on effects, in terms of regional sugar prices, of a dramatic (36%) fall in the EU sugar price, as regional producers look for regional markets?**

- **what would be the knock on effects on regional sugar prices of a further EU sugar price reduction from 2013?**
- **what implications does this carry for intra-regional trade arrangements in sugar and sugar containing food products (including with regard to rules of origin) both within the ESA region and in the wider Southern and Eastern African region?**

The first two questions are particularly pertinent questions, as more and more regionally produced sugar comes onto the market, with current investments and announced investments boosting regional export capacity by between 1 million tons and 11 million tonnes beyond 2014/15.

The latter question with regard to trade flows within the wider Southern and eastern African region is particularly relevant for landlocked Malawi, Zimbabwe and Zambia, all of whose principal transportation links to overseas suppliers pass through SADC configuration members¹⁹.

Outside of South Africa the most obviously attractive alternative regional markets are **Kenya** and **Zambia**, both of which, will offer prices higher than those obtainable on the post-reform EU market (although this will depend on exchange-rate movements). **The very real danger exists that sugar which currently goes to the high-priced EU market will be re-directed to regional markets** (particularly as freight charges increase). If this occurs on a large scale, this could **undermine national sugar prices**. While this would clearly benefit consumers in these markets and enhance the competitiveness of sugar using food product industries it could also lead to escalating trade disputes, if governments seek to protect 'inefficient' producers from intensifying regional competition²⁰. The dangers of a protectionist response would appear to be greater in Kenya, while in Zambia it would be more likely to intensify competition (whether officially or unofficially) and would be more likely to exert a welcomed downward pressure on consumer prices.

A key challenge facing the sugar industry in eastern and southern Africa is how to raise regional demand for regionally produced sugar and sugar-containing products, while maintaining the value of regional sugar markets, in the face of the changed price conditions for exports to the EU market and the enhanced EU export-price competitiveness of sugar-containing value-added products. There is an underlying dilemma in this challenge and how this is to be resolved nationally and regionally in an harmonious manner is by no means clear.

Careful consideration will need to be given to this question in terms of the policies set in place nationally, regionally and inter-regionally to promote growth in demand for regionally produced sugar and sugar-containing products while at the same time

¹⁹ This is the case except if Tanzania, should unequivocally join the ESA group.

²⁰ This is much more of a problem for Kenya than for Zambia given the relative costs of production in these two ESA members.

maintaining the value of the sugar market to the benefit of producers and millers. This will need to include careful consideration of the **trade arrangements to be set in place under EPAs for imports of sugar containing food products** and the **rules of origin provisions for sugar containing food products in both inter-regional and intra regional trade agreements**, and the **design and application of safeguard measures in the sugar value chain**.

- **Reciprocity for Sugar Containing Food Products**

Linked to the foregoing issue is the question of the trade treatment to be accorded sugar and sugar containing food products under an ESA-EU EPA. With EU sugar prices set to decline by 36% by 2009/10, the raw material costs of the EU sugar-containing food-and-drink products will fall sharply. As the USDA has pointed out in the case of Poland, *'less expensive sugar will permit Polish food-processing companies to better compete locally and in export markets'*, since in sectors such as soft drinks and sweets sugar accounts for 30 to 50% of production costs. The impact of EU sugar-sector reforms on the price competitiveness of EU exports of sugar-containing products both directly and via the increased volume of exports which can be financed within WTO financial ceilings (€415 million per annum) will require careful evaluation in low-cost ACP sugar-producing countries, **seeking to develop sugar-based value-added processing for national and regional markets**. The importance of **growing regional industrial demand for regionally produced sugar** in the context of the profound changes taking place on the EU market and prospect of a further round of sugar sector reform in 2013 (see later section for prospects in this regard) **should not be under-estimated**.

The threat from EU exports of high sugar content value added food products also needs, to be seen against the backdrop of the little noted EU reform provisions dealing with the use of non-quota sugar in the chemical and pharmaceutical industries. These provisions will serve to free up funds within the non-annex I budget, currently deployed in support of chemical and pharmaceutical exports, for deployment in support of exports of sugar-containing value-added food products.

This threat also needs to be seen against the backdrop of the "offensive" interests in free trade area negotiations identified by EU exporters during the recent June 25th 2007 symposium on EU Agri-Food Export Interests. During this symposium the EU Association of Biscuit and Confectionary Industries (CAOBISCO) called for efforts to **secure a reduction in applied tariffs on CAOBISCO products in non-EU markets**, either via the WTO or **bilateral agreements** and for a sustained effort to remove non-tariff barriers and simplify rules of origin under bilateral agreements. In its presentation the EU Confederation of Food and Drinks Industries (CIAA) specifically spoke of its offensive interests towards South Africa, identifying specifically offensive interests in amongst other sectors, **beverages, chocolate, biscuits and food preparations**, all areas where strong growth in EU exports has already been occurring (beverages + 72.1% from 1996 to 2005; chocolates, + 38.0%; biscuits + 38.6% food preparations + 106.5%) and all areas where sugar can constitute a significant input into the production process.

The significance of these EU “offensive” interests vis a vis South Africa lies in the fact that:

- the principal transportation routes of three ESA members (Malawi, Zambia and Zimbabwe) all lie through South Africa (or other SADC configuration members);
- the SADC EPAs tariff elimination commitments are likely to be completed by 2012;
- local retailers are increasingly South African owned, with in some instances extensive concessions on duty free imports having been offered to attract investment from these major retailers;
- a trade in re-packaged EU originating goods from South Africa into neighbouring markets is already apparent.

How to deal with these sugar aspects in intra-regional trade arrangements will require careful consideration.

- **Disaggregating Industry Interests**

There is a tendency to look at the sugar sectors in Southern and Eastern Africa as a homogenous whole, largely as a result of the history of revenue sharing arrangements in the region, some of which were closely linked to the distribution of revenues obtained on the high priced EU market. Given the process of EU sugar sector reform underway and the wider processes of change taking place within the EU sugar sector, this commonality of interest will begin to come under pressure and may fragment. Already in response to EU sugar sector reforms one can see a sustained effort by milling companies to open up revenue streams from the by products of raw sugar production, the proceeds of which are not fully pooled and which are not necessarily factored into the price paid to sugar cane farmers²¹. This issue will become more relevant as smallholder sugar production and other forms of non-estate based sugar production grow in the ESA region. This could serve over time, in those countries where revenues on exports to the EU constitute a major component of industry revenues, to exert a downward pressure on the sucrose price paid to farmers²².

This changing reality needs to be taken on board, particularly in the development of government policies with regard to sugar sector restructuring and development. Often governments engage in mobilizing support for complementary investments on the assumption that the primary beneficiary will be local farmers, input suppliers and

²¹ For example if alcohol or ethanol is produced from molasses only an estimated price for the molasses is factored into the common revenue pool which is shared between farmers and millers.

²² The significance of this issue in most ESA countries should not be exaggerated however, given the relatively limited dependency in most competitive exporters on revenues derived from raw sugar sales to the EU market.

employees in the milling operations and not primarily overseas shareholders. This does not always follow. Great care will be needed in ensuring that government measures and support programmes (particularly in the context of the EU financed multi-annual indicative programmes for sugar sector adjustment in ACP countries) actually benefit the intended beneficiaries and build constructive relationship with private sector companies, which support the structural development of the sugar value chain in ways consistent with national and regional development objectives with regard to value addition, employment creation and poverty alleviation²³. This will be a delicate task, with the government needing to 'hold the ring', while revenue sharing arrangements are renegotiated primarily within the industry.

8. RESPONDING TO THE CHALLENGES FACED

- Dealing with Transitional Sugar Access Issues in the ESA Context

In the EC's April 4th market access offer there is no clarity on a range of important issues linked to short term market access. Under the EC offer there is no clarity on the level of extra duty free access to be granted LDC and non-LDCs respectively or on how any additional access will be distributed across the countries concerned. Equally there is no clarity on how the automatic safeguard mechanism will be applied from October 2009, with its application potentially creating a situation where non-least developed sugar exporters could end up being allowed to export less than they have traditionally exported to the EU. Finally there is no clarity on the nature of the price guarantees contained in the EC's April 4th market access offer.

These short term issues are important since for every 10,000 tonnes of sugar exported to the EU in the 2007/08 season, rather than the 2008/09 season, an extra revenue of nearly half a million euro will be generated. For every 10,000 tonnes of sugar exported in 2008/09 season rather than the 2009/10 season the extra revenue generated would be nearly €1.14 million. In short with the value of preferential access to the EU market declining **all ESA exporters have an interest in maximizing their short term exports to the EU market** (i.e. up to September 30th 2009).

Clarity should be actively sought from the EU in each of these key areas, before the EU goes ahead with the unilateral renunciation of the sugar protocol. It should be stressed that if no clarity is provided on these issues then for certain ESA members this will make it more expensive to secure financing for sugar sector adjustments and more difficult to secure new partners for the future restructuring and development of sugar sectors.

²³ See annex 3 for an analysis of the sugar sector MIPs and annex 4 for an analysis of the implications of this experience for smallholder sugar sector development.

With regard to the level of additional duty free access to be granted LDC and non-LDCs respectively, a position should be adopted based on the EC's projections of future sugar imports into the EU. Between 2006 and 2008 EU sugar imports are projected to increase 36.66%, from 3 million tonnes to 4.1 million tonnes. It should be argued that in order to ensure **an equitable distribution of the benefits** implicit in the EC's April 4th market access offer, **all ESA countries should be permitted to increase their sugar exports to the EU in 2008 by 36.66% above the level attained in 2006**, regardless of the specific arrangements under which these sugar exports took place²⁴. Should any ESA country not be able to supply this additional amount then provision should be made for the shortfall to be provided from other regional suppliers exporting to the EU on a pro-rate basis.

With regard to the application of the automatic safeguard clause it would appear **unjust if an EU market access offer presented as opening up new duty free-quota free market access opportunities for ESA sugar exporters were to actually reduce the level of duty free quota free access for some ESA members** (notably the non-least developed country members) as a result of the application of the EC's proposed "dual trigger" automatic safeguard mechanism. Against this background, it would appear appropriate within the EC's transitional arrangements for non-least developed ESA sugar exporters to be **guaranteed a minimum level of duty free-quota free access** to the EU market, so that they were not left worse off by the application of the automatic safeguard clause from October 2009. This level should be set in line with the projected expansion of EU imports of sugar between 2006 and 2009, an increase of some 40% (from 3 million tonnes in 2006 to 4.2 million tonnes in 2009), **with non least developed exporters being guaranteed duty free access to the EU market at least 40% above the level of exports to the EU attained in 2006**.

Since the EC is seeking to promote more market related prices on EU sugar markets, the European Commission should be pressed to come clean on the actual market prices for raw and refined sugar prevailing in the EU, with prices paid to ACP suppliers from October 2009 being based on the prevailing EU market prices, rather than the reference prices in the EU. This would provide more guarantees and security over the likely price range to be paid for ACP raw sugar delivered to what until 2010 will be a restricted number of importers.

Providing clarity in these three areas will provide greater commercial certainty to ESA sugar exporters and thereby reduce the costs of financing provided for sugar sector restructuring and development activities.

- **Responding to EU Price Reductions and the Changing EU Market**

Looking beyond the immediate transitional market access issues, there is the question of how the ESA region should respond to the planned EU price reductions and the

²⁴ For example in the 2005/06 season Malawi exported to the EU market 21,500 tonnes under the sugar protocol, 10,000 tonnes under the special preferential sugar arrangement and 10,450 tonnes under the EBA initiative, a total of 41,950 tonnes. Under this formula, in 2008 Malawi would be allowed to export 57,328.9 tonnes.

possibility of further EU sugar price reductions in 2013. In many respects this process of responding is already underway. In some countries a long established government supported process of sugar sector restructuring is underway. In other countries this process of sugar sector restructuring is largely being driven by the private sector, with government and EC supported adjustment measures being added on, some times in a coherent fashion and some times in an incoherent fashion.

What is clear is that dramatic changes in ownership patterns within the sugar sector and the distribution of sugar production within the region are underway. This process is far from complete with even more dramatic changes likely to take place in the coming years. In broad terms in the ESA region major sugar sector corporate players have been investing extensively in sugar production in low cost least developed countries, where production has been and continues to expand. This is occurring both within the ESA region and beyond. In a context of the EU sugar sector reforms this will, in and of itself, create a new dynamic in sugar trade relations between the ESA region and the EU.

The question arises:

what public sector interventions can take place to try and steer this process of private sector based restructuring in directions consistent with broader development policy objectives, most notably those related to the promotion of value addition, employment creation and income growth in ESA countries?.

The first level of response relates to **cost reduction**. Reducing costs will be essential if ESA producers are to be able to profitably serve EU sugar markets at the much lower prices which prevail in the coming period. While this is primarily the responsibility of the sugar sector enterprises, there is scope for public sector support at three levels:

- general infrastructure and public amenity provision to reduce operational costs of production and transportation;
- the provision from the public purse of social, health and education infrastructure previously funded from sugar industry revenues;
- support for improvements in agricultural productivity and yields, particularly in smallholder based farming systems.

In each of these areas the extent to which public authorities in the ESA region can take up more responsibilities in these areas and in many areas some forms of public-private sector partnerships will be required. This poses problems in some countries for the extension of EC support to these processes. Greater clarity is needed on how EC provided public assistance can be extended to **operational activities implemented through private sector bodies**, in those instances where this provides a more **efficient and effective mechanism** for the delivery of support than the use of public sector bodies for aid delivery.

At the policy level the precise terms and conditions under which EU public funds may be used in support or cost saving programmes of measures implemented through private

sector bodies will need to be urgently clarified. The frame of reference for the resolution of this policy issue should increasingly be the **EU's own internal practice** with regard to the extension of public support to agricultural restructuring to meet the competitiveness challenges faced in a context of global trade liberalization, rather than the EU's traditional development cooperation approach.

Linked to this should be an effort to identify more clearly the **precise measures and programmes** for which ESA sugar producers and exporters are seeking EC support with cost reduction and production adjustment. This will assist in clarifying the nature of the policy issues to be addressed.

The second level of policy response relates to opening up **new revenue streams from sugar cane production**. Opening up new revenue streams from sugar cane production, will reduce the dependence of ESA exporters on the price obtained from raw sugar exports to the EU market and thus assist them in adapting to the process of price reductions underway as a consequence of EU sugar sector reform.

A number of notable initiatives are underway in the southern and eastern African region with regard to opening up new revenue streams. These include:

- the development of electricity co-generation from bagasse and even cane waste, for both own electricity consumption in the mills (thereby reducing energy costs of milling), and even commercial sales to the national grid;
- the production of ethanol from molasses for both own transport fuel consumption and commercial sale²⁵;
- the production of alcohol for commercial export.

A number of policy issues arise in this context. The first relates to the distribution of the benefits of these innovations within the sugar industry. In a number of instances these innovations primarily benefit the millers, without any consideration being given to how farmers can also gain benefits from the opening up of these new revenue streams. In some instances it is assumed that supporting such innovations will automatically benefit both millers and sugar cane growers, although this is by no means a certainty. In this context a case can be made for **the deployment of public funding in support of the development and adoption of innovations which open up new revenue streams, with the specific intent of ensuring sugar cane growers also share in these new revenue streams being opened.**

A case can be made for public support to the **introduction of the necessary policy changes** to open up commercial opportunities for the sale of electricity from co-

²⁵ Unless a further round of EU sugar price reductions occurs in 2013 or freight charges continue to rise dramatically, there would appear to be little case for the production of ethanol from cane juice, in the context of restricted duty free access to the EU market.

generation to the national grid and develop local markets for locally produced ethanol production.

A case can also be for public support to measures to promote the generalized adoption of innovations to open up new revenue streams from sugar cane production, including through support for marketing and market development programmes .

Appropriate funding instruments will need to be created to support this process, which can be **swiftly** and **efficiently** accessed and which provide financial support on terms and conditions **sufficiently attractive** to stimulate the adoption of innovations in this area.

A third level of policy response relates to the establishment of targeted programmes of support which assist ESA sugar producers in **adapting to the radically changing market conditions** which will be faced, as a consequence of EU sugar sector reforms, the associated denunciation of the sugar protocol and the full implementation of the EC's April 4th market access offer. Such targeted programmes of support to assist ESA exporters in finding their way around changing markets will be essential if the region is not to be locked into the export of raw sugar, the price of which is likely to be declining on the EU market and even regional markets.

Particular efforts will need to be made in assisting ESA producers in developing and serving "*luxury purchase*" components of the EU market. Two notable components in this regard are the "fair trade" market and the "organic" market. The economic significance of such markets should not be under-estimated in a context of declining EU raw sugar prices. This can be illustrated by consideration of the "fair trade" sugar market. The "fair trade" premium, which is paid directly to certified "fair trade" sugar producers associations, is US \$ 60 per tonne. An amount equivalent in some southern and eastern African countries to around 30% of the sucrose price paid to smallholder sugar farmers. The significance of this premium will increase over time as EU raw sugar prices decline.

The problem with the "fair trade" sugar market at the moment is its limited size. In this context support is required for efforts to develop demand for "fair trade" sugar in major EU markets, most notably the UK. Indeed, a strong case can be made for seeking to replicate the experience of the "fair trade" bananas in the sugar sector. This will require the financing of a sustained programme, over 3 to 4 years, to grow the "fair trade" sugar market, by taking it out of the speciality shops and into main stream supermarkets. The ultimate aim of this programme should be to , persuade some of the major supermarket chains to convert to 100% "fair trade" sugar (replicating the transition which has taken place in the banana sector). The significance of this should not be under-estimated. If the Co-operative supermarket chain were to convert to 100% "fair trade" sugar this would create a market for approximately 70,000 tonnes of sugar. If Sainsbury's were to similarly convert to a 100% "fair trade" sugar as well the size of this market would rise to around 210,000 tonnes. This would represent a level of demand of considerable commercial interest to the expanding smallholder sugar farming sector in the ESA region

and could serve to largely insulate smallholder sugar farmers from the revenue effects of EU sugar price reductions.

A strong case can be made for the extension of EU funding to a two pronged pronged programme for the development of this market component, with one prong supporting market development efforts in the UK and the second prong supporting “fair trade” certification in the ESA region²⁶.

The forgoing is simply one example of the type of targeted support to the **development of marketing of ESA sugar** which will be required, if the ESA sugar sector is continue to profitably trade sugar into the EU market under the new market conditions faced. Other “luxury purchase” markets for sugar products exist²⁷, which will need to be developed. Successful development of these markets will provide the basis for investments in the production of a more diverse and differentiated range of sugar products in the ESA region in the future.

A fourth level of policy response relates to supporting a process of **moving up the sugar value chain** in serving national, regional and EU markets. This is of course closely linked to the market effects and consequences of EU policy changes. What is clear is that while the references price for raw sugar is set to decline dramatically, prices of white sugar and other speciality sugar products are likely to be less severely affected. This will require assistance to be extended to ESA sugar producers in **developing production** to serve these high value markets.

Traditionally as a result of the high raw sugar prices obtainable on the EU market there was little incentive to invest in value added processing in many ESA sugar sectors. This situation is being radically transformed, with a new imperative to move up the sugar value chain being created by the process of EU price reductions for raw sugar. While investments are occurring in making this transition in some countries on the basis of either government supported restructuring programmes or changing corporate investment patterns, it is proving difficult in other ESA countries to mobilize such financing, given the uncertainties created by the process of EU sugar reform. These uncertainties are leading private financial institutions to increase the cost of financing for sugar related investments in the ESA region, as the perception of the risks associated with sugar sector investments change.

In this context there appears to be a need for targeted investment support instruments (notably **low cost loan facilities**) to provide financing to assist ESA sugar sectors in **moving up the sugar value chain**, whether the production is destined for EU market, national markets, regional markets, or newly identified third country markets.

²⁶ It should be noted that in other ACP regions, notably the Caribbean, moves towards “fair trade” certification of smallholder sugar producers are already underway.

²⁷ Barbados for example, is developing exports of premium sugar in tins to high income UK consumers through delicatessen’s and retail outlets such as Harrods, with these efforts being given a boost by the use of this product in the Royal Enclosure at the Royal Ascot race meeting.

Clearly the scope for responding to EU price reductions will vary from ESA country to ESA country and between various components of the sugar industry in the ESA region. What is required is the establishment of global financing facilities and programmes, which can support the implementation of country specific responses in a **swift and efficient** manner. This is a particularly important issue, since the evolving situation on the EU sugar market will make adjustment processes very 'time sensitive'.

What will be necessary throughout the ESA region will be the building of sugar sector strategies which take into account the changing nature of EU sugar markets, the emergence of new routes to EU markets and the evolving patterns of corporate ownership within the ESA sugar sector. Building successful public/private sector partnership to respond to the market changes faced, in ways which support national policy objectives with regard value addition, employment creation and income growth will be critical.

- Managing Reciprocal Trade in Sugar and Sugar Containing Food Products

While in the short term the importance of the EU market to the ESA sugar sector will increase, in the medium to long term the additional value obtainable on the EU market will decline and probably disappear reducing considerably the significance of EU as a market for raw sugar. In this context, a major thrust of national and regional policies should be to promote the development for regional demand for sugar both for direct consumption and for industrial use in value added food products.

In many respects given the sugar consumption profile for sugar in the ESA region, the greatest scope for expansion of sugar consumption would appear to be through the consumption of sugar in value added food products²⁸. This makes the trade regime established for sugar containing food products under an EPA and other trade agreement of critical importance.

Under other FTAs between the EU and African countries a piecemeal approach to the sugar value chain has been adopted, with tariff protection being maintained for sugar, but being dismantled for high sugar content value added food products. This has resulted in increased volumes of imports of sugar containing food products, a decline in industrial demand for locally produced sugar²⁹ and radical changes in the investment orientation of locally established multinationals operating in the sugar based food products sector.

Given the growing surplus of sugar being produced in the ESA and wider southern and eastern African region, this situation needs to be avoided under EPAs and other trade agreements. This implies:

- a) the exclusion of high sugar content value added food products from tariff elimination commitments under EPAs;

²⁸ This being said it should be noted that according to ISO figures there has been a phenomenal growth in ESA consumption since 1999, with a 30.1% expansion up to 2005 (with this being even larger -39.7% - if the decline in Zimbabwean consumption is factored out). See Annex 1 for details.

²⁹ This situation was only reversed when special safeguard duties were introduced.

- b) the maintenance of special safeguards for sugar containing food products³⁰;
- c) the establishment of special rules of origin for EU sugar containing products, requiring the sugar to originate in the EU or the ESA region³¹.

If these measures are set in place this will create more favourable conditions for the development of local value added processing for national and regional markets.

However it will leave unaddressed the critical issue of **sugar pricing policy**. If the aim is to develop local sugar based value added processing to stimulate industrial demand for locally produced sugar, then this can best be achieved by **allowing sugar prices to fall**, making it more economic to produce value added food products from locally produced sugar. However, allowing local sugar prices to fall in the context of the revenue squeeze which will arise from declining EU sugar prices, is likely to meet strong resistance from sugar sector stakeholders. The scale of this resistance will of course be closely linked to the level of competition prevailing on national markets in the sugar sector³².

This represents a significant dilemma for ESA governments and it is one which will need to be taken up and addressed. In this context the use of public funds to support sugar industry restructuring, development and marketing initiatives could well be usefully linked to targets for the local pricing of sugar.

- **Managing Regional Trade in Sugar and Sugar Containing Food Products**

Linked to this issue will be the related question of the regional trade regime to be established for sugar and sugar containing food products. While nominally within COMESA there is free trade in sugar, some COMESA members have made extensive use of safeguard mechanisms to protect their sugar sectors from regional competition. As has been suggested, as EU sugar prices decline so regional markets could become more attractive to regional sugar producers. Given the level of the projected sugar surplus in the region this could create a situation where more and more COMESA members feel that they need to make use of safeguard measures to protect their domestic sugar sectors.

This potential scenario raises a policy challenge for COMESA. Should they stick with their current nominal free trade policy in the sugar sector and risk the emergence of increased use of safeguard measures? Or should the COMESA revise its sugar trade policy, to promote a moderated trade in sugar and sugar containing food products, so as to progressively introduce competition on national sugar markets to the benefit of consumers and processors?

³⁰ A mechanism of particular importance to land locked ESA members whose principal transportation routes run through SADC configuration member states and whose retail sector are increasingly dominated by South African owned supermarket chains.

³¹ A provision already proposed by the ESA region.

³² In many ESA countries competition in sugar supply is minimal, while the regulatory framework to prevent abuse of a dominant market position is gravely under-developed, this can lead to strong complaints from consumer and industrial users of sugar over the costs of sugar on local markets.

Linked to this will be the tricky issue of the rules of origin to be established for sugar containing food products to be traded within the region. Some ESA members import sugar from outside of the region for use in export orientated food processing industries. Given the surplus sugar within the ESA region, should not rules of origin on intra-regional trade in sugar products be concluded which require the use of regionally produced sugar in sugar products traded intra-regionally under preferential trade arrangements? This is a tricky question, since under current circumstances it could disrupt existing export orientated value added food product production in certain ESA members. Nevertheless it would appear to be an issue which is better addressed up front rather than leaving it to the random adoption of safeguard measures which undermine the principles of free trade on which the COMESA is founded.

- **Dealing with Sugar under EPAs**

The EC's July 20th 2007 decision to adopt a proposal for a Council decision to denounce the sugar protocol with effect from the 1st October 2009, brings the inevitability of having to deal with future ESA-EU sugar sector relations in the context of the current Economic Partnership Agreements one step closer. The only final step remaining is the adoption by the EU Council of this European Commission proposal which is scheduled for September 2007. Thus, unless there is strong resistance to the EC proposal within the EU Council of Ministers, within a matter of weeks the sugar protocol as the basis for the conduct of ESA-EU sugar sector relations from October 1st 2009 will have been dismantled.

This does not mean that ESA sugar protocol beneficiaries should simply accept this unilateral EU denunciation of the sugar protocol. Rather in this context the debate **needs to rapidly shift from preserving the sugar protocol to ensuring ACP sugar producers are effectively assisted in responding to the new market realities created not only by the denunciation of the sugar protocol, but the wider processes of change underway impacting on ACP-EU sugar sector relations.** In this context the EC's bland assertion that the denunciation of the sugar protocol forms "*part of the process of the EU enhancing its market access for ACP countries in the context of EPAs*", needs to be highlighted as **a fundamental misrepresentation** of the new economic realities facing ACP sugar exporters as a result of the wider process of EU sugar sector reform. There is **absolutely no evidence** that the renunciation of the sugar protocol will meaningfully "enhance" the market situation of ACP sugar suppliers. Indeed all the indications are that **the majority of ACP sugar exporters will face extreme difficulties in maintaining their sugar trade with the EU**, following the outcome of reform and the renunciation of the sugar protocol. While in the short term the ESA region is one of the least affected ACP regions, in the medium to long term it is likely to be profoundly affected. This reality needs to be concretely highlighted.

It will not be sufficient simply to criticize the EC/EU position. What EU member states will be looking for is a constructive way out of the impasse faced. This will require individual ESA Governments and the region as a whole, to put forward constructive ways out of the dilemmas faced, within the framework of the broad trajectory of the internal process of CAP reform and the broad parameters of the EU policy response, both in an

ACP context, but also importantly, with reference to the internal EU process of restructuring support

This will require a very careful articulation of the policy responses from the EC which ACP sugar exporters are looking for. There is currently a small window of opportunity for putting forward the ESA regions preferred policy response, notably during the final stages of the EPA negotiations. In order to create a receptive environment for these suggestions immediate emphasis should be placed on ensuring that a **stable and transparent** basis for future sugar sector trade relations is established *before* the denunciation of the sugar protocol. In this context emphasis should be placed on the following:

Transitional Issues

- ensuring the transitional issues linked to the levels of additional market access to be granted LDCs and non-LDCs (and the basis for its distribution) are clearly elaborated on the basis of the EC's own projected 36.66% expansion of EU sugar imports between 2006 and 2008, with this expansion being evenly shared across ESA members based on the level of their total sugar exports to the EU attained in 2006;
- ensuring a minimum level of expanded access for individual ESA non-LDCs is guaranteed *before* the application of the automatic safeguard provisions can be invoked;
- ensuring greater clarity is provided on the "*certain price level*" to be applied, with this being based on the market prices in the EU not the reference price;
- the ESA region putting forward concrete proposals on how the three foregoing issues should be resolved and actively lobbying EU member states around the proposed approach;

Aid for Trade and Restructuring Support Issues

- ensuring effective 'aid for trade' support is extended to undertaking priority sugar sector **production adjustment; marketing adjustments** and **social adjustments**, including through targeted programmes of assistance to **market development**, the establishment of **low cost loan financing facilities** for sugar sector **production adjustment**³³, and **grant based support** for sugar farmers organizations to assist them in strengthening their position within the marketing chain, in the context of the radically changed market environment;

³³ In a context where market uncertainties are dramatically increasing the costs of bank financing for sugar sector related investments.

- ensuring early and effective delivery of restructuring support, through the adoption of regional “best practices” to programme design and aid delivery, including where necessary the introduction of procedural changes to facilitate early aid deployment in support of national and regional priority actions (e.g. agreement to reimburse previous expenditures in mutually agreed priority areas, given the long lead time in EC decision making processes³⁴);
- ensuring internal EU restructuring support is in part used to ensure the creation of new market opportunities for ACP sugar exports, at established market prices, within the framework of the envisaged expansion of ACP/LDC sugar exports and the existence of finite dedicated raw cane sugar refining capacity in the EU, with a dialogue with European sugar sector stakeholders being supported on the future evolution of the EU sugar market;

Non-Tariff Issues

- ensuring a dialogue takes place on the arrangements for the issuing of **sugar import licenses** from the beginning of 2010 in order to ensure that those ESA sugar sectors with no direct EU corporate engagement are not systematically discriminated against in the allocation of licenses;
- ensuring all sugar related internal EU regulations are reviewed and where necessary annulled, if they create administrative barriers to trade in sugar or sugar containing products in the new more liberalized trading environment;
- ensuring that the enhanced surveillance mechanism for high sugar content products is only applied to products which are clearly being exported for the purpose of circumvention of the basic sugar import regime, so that this enhanced surveillance mechanism does not become an obstacle to the development of value added sugar based product exports in the ESA region;
- ensuring rules of origin for sugar containing products are reviewed to ensure that no unnecessarily strict provisions are applied, which de facto constitute barriers to trade in high sugar content value added products;
- ensuring a strengthening of local food safety compliance capacities so to avoid the emergence of SPS disputes on products within the sugar value chain

³⁴ This is very important given the ‘use of lose it’ approach the annual allocations under the EC’s multi-annual indicative programme for ACP sugar sector adjustment support.

Tariff Issues

- ensuring that sugar and sugar containing products are treated as sensitive within the ESA tariff elimination offer, with appropriate **exclusions**, **“back loading”** and **safeguards** being established to facilitate the development of sugar based value added processing in the ESA region for national and regional markets;

Responding to the Challenges Faced

- Dealing with Transitional Sugar Access Issues in the ESA Context

In the EC's April 4th market access offer there is no clarity on a range of important issues linked to short term market access. Under the EC offer there is no clarity on the level of extra duty free access to be granted LDC and non-LDCs respectively or on how any additional access will be distributed across the countries concerned. Equally there is no clarity on how the automatic safeguard mechanism will be applied from October 2009, with it's application potentially creating a situation where non-least developed ESA sugar exporters could end up being allowed to export less than they have traditionally exported to the EU. Finally there is no clarity on the nature of the price guarantees contained in the EC's April 4th market access offer.

These short term issues are important since for every 10,000 tonnes of sugar exported to the EU in the 2007/08 season, rather than the 2008/09 season, an extra revenue of nearly half a million euro will be generated. For every 10,000 tonnes of sugar exported in 2008/09 season rather than the 2009/10 season the extra revenue generated would be nearly €1.14 million. In short with the value of preferential access to the EU market declining **all ESA exporters have an interest in maximizing their short term exports to the EU market** (i.e. up to September 30th 2009).

Clarity should be actively sought from the EU in each of these key areas, *before* the EU goes ahead with the unilateral renunciation of the sugar protocol. It should be stressed that if no clarity is provided on these issues then for certain ESA members this will make it more expensive to secure financing for sugar sector adjustments and more difficult to secure new partners for the future restructuring and development of their sugar sectors.

With regard to the level of additional duty free access to be granted LDC and non-LDCs respectively, a position could usefully be adopted based on the EC's projections of future sugar imports into the EU. In January 2007 the European Commission projected EU sugar imports to increase 36.66%, from 3 million tonnes in 2006 to 4.1 million tones in 2008. It could be argued that in order to ensure **an equitable distribution of the**

benefits implicit in the EC's April 4th market access offer, **all ESA countries should be permitted to increase their sugar exports to the EU in 2008 by 36.66% above the level attained in 2006**, regardless of the specific arrangements under which these sugar exports took place³⁵. Should any ESA country not be able to supply this additional amount then provision could be made for the shortfall to be provided from other regional suppliers exporting to the EU on a pro-rate basis.

With regard to the application of the automatic safeguard clause it would appear **unjust if an EU market access offer presented as opening up new duty free-quota free market access opportunities for ESA sugar exporters were to actually reduce the level of duty free quota free access for some ESA members** (notably the non-least developed country members) as a result of the application of the EC's proposed "dual trigger" automatic safeguard mechanism. Against this background, it would appear appropriate within the EC's transitional arrangements for non-least developed ESA sugar exporters to be **guaranteed a minimum level of duty free-quota free access** to the EU market, above and beyond the level of their exports in 2006, so that they are not left worse off by the application of the automatic safeguard clause from October 2009. This level should be set in line with the projected expansion of EU imports of sugar between 2006 and 2009, an increase of some 40% (from 3 million tonnes in 2006 to 4.2 million tonnes in 2009), **with non least developed exporters being guaranteed duty free access to the EU market at least 40% above the level of exports to the EU attained in 2006**.

Since the EC is seeking to promote more market related prices on EU sugar markets, the European Commission should be pressed to come clean on the actual market prices for raw and refined sugar prevailing in the EU, with prices paid to ACP suppliers from October 2009 being based on the prevailing EU market prices, rather than the reference prices in the EU. This would provide more guarantees and security over the likely price range to be paid for ACP raw sugar delivered to what until 2010 will be a restricted number of importers.

Providing clarity in these three areas will provide greater commercial certainty to ESA sugar exporters and thereby reduce the costs of financing provided for sugar sector restructuring and development activities.

- **Responding to EU Price Reductions and the Changing EU Market**

Looking beyond the immediate transitional market access issues, there is the question of how the ESA region should respond to the planned EU price reductions and the possibility of **further EU sugar price reductions in 2013**. In many respects this process of responding is already underway. In some countries a long established government supported process of sugar sector restructuring is underway. In other countries this process of sugar sector restructuring is largely being driven by the private sector, with

³⁵ For example in the 2005/06 season Malawi exported to the EU market 21,500 tonnes under the sugar protocol, 10,000 tonnes under the special preferential sugar arrangement and 10,450 tonnes under the EBA initiative, a total of 41,950 tonnes. Under this formula, in 2008 Malawi would be allowed to export 57,328.9 tonnes.

government and EC supported adjustment measures being added on, some times in a coherent fashion and some times in an incoherent fashion.

What is clear is that dramatic changes in ownership patterns within the sugar sector and the distribution of sugar production within the region are underway. This process is far from complete with even more dramatic changes likely to take place in the coming years. In broad terms in the ESA region major sugar sector corporate players have been investing extensively in sugar production in low cost least developed countries, where production has been and is continuing to expand. This is occurring both within the ESA region and beyond. In a context of the EU sugar sector reforms this will, in and of itself, create a new dynamic in sugar trade relations between the ESA region and the EU.

The question arises:

what public sector interventions can take place to try and steer this process of private sector based restructuring in directions consistent with broader development policy objectives, most notably those related to the promotion of greater value addition, employment creation and income growth in ESA countries?

The first level of response relates to **cost reduction**. Reducing costs will be essential if ESA producers are to be able to profitably serve EU sugar markets at the much lower prices which prevail in the coming period. While this is primarily the responsibility of the sugar sector enterprises, there is scope for public sector support at three levels:

- general infrastructure and public amenity provision to reduce operational costs of production and transportation;
- the provision from the public purse of social, health and education infrastructure previously funded from sugar industry revenues;
- support for improvements in agricultural productivity and yields, particularly in smallholder based farming systems.

In each of these areas the extent to which public authorities in the ESA region can take up more responsibilities in these areas varies. In many countries various forms of public-private sector partnerships will be required. This poses problems in some countries for the extension of EC support to these processes. Greater clarity is needed on how EC provided public assistance can be extended to **operational activities implemented through private sector bodies**, in those instances where this provides a more **efficient and effective mechanism** for the delivery of support than the use of public sector bodies.

At the policy level the precise terms and conditions under which EU public funds may be used in support or cost saving programmes of measures implemented through private sector bodies will need to be urgently clarified. The frame of reference for the resolution of this policy issue should increasingly be the **EU's own internal practice** with regard to the **extension of public support to agricultural restructuring** to meet the

competitiveness challenges faced in a context of global trade liberalization, rather than the EU's traditional development cooperation approach.

It needs to be recognized that with the process of EU price reductions well underway, the delivery of assistance on the ground in support of cost reducing measures is extremely 'time sensitive'. The speed of aid delivery on the ground is a critical issue which needs to be urgently addressed. Hence the need to allow extensive pre-financing of measures in agreed priority areas.

Linked to this should be an effort to identify more clearly the **precise measures and programmes** for which ESA sugar producers and exporters are seeking EC support with cost reduction and production adjustment. This will assist in clarifying the nature of the policy issues to be addressed.

The second level of policy response relates to opening up **new revenue streams from sugar cane production**. Opening up new revenue streams from sugar cane production, will reduce the dependence of ESA exporters on the price obtained from raw sugar exports to the EU market and thus assist them in adapting to the process of price reductions underway as a consequence of EU sugar sector reform.

A number of notable initiatives are underway in the southern and eastern African region with regard to opening up new revenue streams. These include:

- the development of electricity co-generation from bagasse and even cane waste, for both own electricity consumption in the mills (thereby reducing energy costs of milling), and even commercial sales to the national grid;
- the production of ethanol from molasses for both own transport fuel consumption and commercial sale³⁶;
- the production of alcohol for commercial export.

A number of policy issues arise in this context. The first relates to the **distribution of the benefits of these innovations within the sugar industry**. In a number of instances these innovations primarily benefit the millers, without any consideration being given to how farmers can also gain benefits from the opening up of these new revenue streams. In some instances it is assumed that supporting such innovations will automatically benefit both millers and sugar cane growers, although this is by no means a certainty. In this context a case can be made for **the deployment of public funding in support of the development and adoption of innovations which open up new revenue streams, with the specific intent of ensuring sugar cane growers also share in these new revenue streams being opened**.

³⁶ Unless a further round of EU sugar price reductions occurs in 2013 or freight charges continue to rise dramatically, there would appear to be little case for the production of ethanol from cane juice, in the context of un-restricted duty free access to the EU market.

A case can be made for public support to the **introduction of the necessary policy changes** to open up commercial opportunities for the sale of electricity from co-generation to the national grid and for the development of local markets for locally produced ethanol.

A case can also be for public support to measures to promote the generalized adoption of innovations to open up new revenue streams from sugar cane production, including through support for marketing and market development programmes (e.g. for alcohol production).

Appropriate funding instruments will need to be created to support this process, which can be **swiftly** and **efficiently** accessed and which provide financial support on terms and conditions **sufficiently attractive** to stimulate the adoption of innovations in this area.

A third level of policy response relates to the establishment of targeted programmes of support which assist ESA sugar producers in **adapting to the radically changing market conditions** which will be faced as a consequence of: EU sugar sector reforms; the associated denunciation of the sugar protocol; and the full implementation of the EC's April 4th market access offer. Such targeted programmes of support to assist ESA exporters in finding their way around changing markets will be essential if the region is not to be locked into the export of raw sugar, the price of which is likely to continue to decline on the EU market and even regional markets.

Particular efforts will need to be made in assisting ESA producers in developing and serving "***luxury purchase***" components of the EU market. Two notable components in this regard are the "fair trade" market and the "organic" market. The economic significance of such markets should not be under-estimated in a context of declining EU raw sugar prices. This can be illustrated by consideration of the "fair trade" sugar market. The "fair trade" premium, which is paid directly to certified "fair trade" sugar producers associations, is US \$ 60 per tonne. An amount equivalent in some southern and eastern African countries to around 30% of the sucrose price paid to smallholder sugar farmers. The significance of this premium will increase over time as EU raw sugar prices decline.

The problem with the "fair trade" sugar market at the moment is its limited size. In this context support is required for efforts to develop demand for "fair trade" sugar in major EU markets, most notably the UK. Indeed, a strong case can be made for seeking to replicate the experience of the "fair trade" bananas in the sugar sector. This will require the financing of a sustained programme, over 3 to 4 years, to grow the "fair trade" sugar market, by taking it out of the speciality shops and into main stream supermarkets. The ultimate aim of this programme should be to persuade some of the major supermarket chains to convert to 100% "fair trade" sugar (replicating the transition which has taken place in the banana sector). The significance of this should not be under-estimated. If the Co-operative supermarket chain were to convert to 100% "fair trade" sugar this would create a market for approximately 70,000 tonnes of sugar. If Sainsbury's were also to similarly convert to a 100% "fair trade" sugar, the size of this market would rise to

around 210,000 tonnes. This would represent a level of demand of considerable commercial interest to the expanding smallholder sugar farming sector in the ESA region and could serve to largely insulate smallholder sugar farmers from the revenue effects of EU sugar price reductions.

A strong case can be made for the extension of EU funding to a two pronged programme for the development of this market component, with one prong supporting market development efforts in the UK and the second prong supporting “fair trade” certification in the ESA region³⁷.

The forgoing is simply one example of the type of targeted support to the **development of marketing of ESA sugar** which will be required, if the ESA sugar sector is to continue to profitably trade sugar into the EU market under the new market conditions faced. Other “luxury purchase” markets for sugar products exist³⁸, which will need to be developed. Successful development of these markets will provide the basis for investments in the production of a more diverse and differentiated range of sugar products in the ESA region in the future.

A fourth level of policy response relates to supporting a process of **moving up the sugar value chain** in serving national, regional and EU markets. This is of course closely linked to the market effects and consequences of EU policy changes. What is clear is that while the reference price for raw sugar is set to decline dramatically, prices of white sugar and other speciality sugar products are likely to be less severely affected. This will require assistance to be extended to ESA sugar producers in **developing production** to serve these high value markets.

Traditionally as a result of the high raw sugar prices obtainable on the EU market there was little incentive to invest in value added processing in many ESA sugar sectors. This situation is being radically transformed, with a new imperative to move up the sugar value chain being created by the process of EU price reductions for raw sugar. While investments are occurring in making this transition in some countries on the basis of either government supported restructuring programmes or changing corporate investment patterns, it is proving difficult in other ESA countries to mobilize such financing, given the uncertainties created by the process of EU sugar reform. These uncertainties are leading private financial institutions to increase the cost of financing for sugar related investments in the ESA region, as the perception of the risks associated with sugar sector investments change.

In this context there appears to be a need for targeted investment support instruments (notably **low cost loan facilities**) to provide financing to assist ESA sugar sectors in

³⁷ It should be noted that in other ACP regions, notably the Caribbean, moves towards “fair trade” certification of smallholder sugar producers are already underway.

³⁸ Barbados for example, is developing exports of premium sugar in tins to high income UK consumers through delicatessen’s and retail outlets such as Harrods, with these efforts being given a boost by the use of this product in the Royal Enclosure at the Royal Ascot race meeting.

moving up the sugar value chain, whether the production is destined for EU market, national markets, regional markets, or newly identified third country markets.

Clearly the scope for responding to EU price reductions will vary from ESA country to ESA country and between various components of the sugar industry in the ESA region. What is required is the establishment of global financing facilities and programmes, which can support the implementation of country specific responses in a **swift** and **efficient** manner. This is a particularly important issue, since the evolving situation on the EU sugar market will make adjustment processes very 'time sensitive'.

What will be necessary throughout the ESA region will be the building of sugar sector strategies which take into account the changing nature of EU sugar markets, the emergence of new routes to EU markets and the evolving patterns of corporate ownership within the ESA sugar sector. Building successful public/private sector partnership to respond to the market changes faced, in ways which support national policy objectives with regard value addition, employment creation and income growth will be critical.

- Managing Reciprocal Trade in Sugar and Sugar Containing Food Products

While in the short term the importance of the EU market to the ESA sugar sector will increase, in the medium to long term the additional value obtainable on the EU market will decline and probably disappear, reducing considerably the significance of EU as a market for raw sugar. In this context, a major thrust of national and regional policies should be to promote the development for regional demand for sugar both for direct consumption and for industrial use in value added food products.

In many respects given the sugar consumption profile for sugar in the ESA region, the greatest scope for expansion of sugar consumption would appear to be through the consumption of sugar in value added food products³⁹. This makes the ESA import regime established for sugar containing food products under an EPA and other trade agreement of critical importance.

Under other FTAs between the EU and African countries a piecemeal approach to the sugar value chain has been adopted, with tariff protection being maintained for sugar, but being dismantled for high sugar content value added food products. This has resulted in increased volumes of imports of sugar containing food products, a decline in industrial demand for locally produced sugar⁴⁰ and radical changes in the investment orientation of locally established multinationals operating in the sugar based food products sector.

Given the growing surplus of sugar being produced in the ESA and wider southern and eastern African region, this situation needs to be avoided under EPAs and other trade agreements. This implies:

³⁹ This being said it should be noted that according to ISO figures there has been a phenomenal growth in ESA consumption since 1999, with a 30.1% expansion up to 2005 (with this being even larger, +39.7%, if the decline in Zimbabwean consumption is factored out). See Annex 1 for details.

⁴⁰ This situation was only reversed when special safeguard duties were introduced.

- d) the exclusion of high sugar content value added food products from tariff elimination commitments under EPAs;
- e) the maintenance of special safeguards for sugar containing food products⁴¹;
- f) the establishment of special rules of origin for EU sugar containing products, requiring the sugar to originate in the EU or the ESA region⁴².

If these measures are set in place this will create more favourable conditions for the development of local value added processing for national and regional markets.

However it will leave unaddressed the critical issue of **sugar pricing policy**. If the aim is to develop local sugar based value added processing to stimulate industrial demand for locally produced sugar, then this can best be achieved by **allowing sugar prices to fall**, making it more economic to produce value added food products from locally produced sugar. However, allowing local sugar prices to fall in the context of the revenue squeeze which will arise from declining EU sugar prices, is likely to meet strong resistance from sugar sector stakeholders. The scale of this resistance will of course be closely linked to the level of competition prevailing on national markets in the sugar sector⁴³.

This represents a significant dilemma for ESA governments and it is one which will need to be taken up and addressed. In this context the use of public funds to support sugar industry restructuring, development and marketing initiatives could well be usefully linked to targets for the local pricing of sugar.

- **Managing Regional Trade in Sugar and Sugar Containing Food Products**

Linked to this issue will be the related question of the regional trade regime to be established for sugar and sugar containing food products. While nominally within COMESA there is free trade in sugar, some COMESA members have made extensive use of safeguard mechanisms to protect their sugar sectors from regional competition. As has been suggested, as EU sugar prices decline so regional markets could become more attractive to regional sugar producers. Given the level of the projected sugar surplus in the region this could create a situation where more and more COMESA members feel that they need to make use of safeguard measures to protect their domestic sugar sectors from neighbouring regional sugar suppliers.

This potential scenario raises a policy challenge for COMESA. Should they stick with their current nominal free trade policy in the sugar sector and risk the emergence of increased use of safeguard measures? Or should the COMESA revise its sugar trade policy, to promote a managed trade in sugar and sugar containing food products, so as to

⁴¹ A mechanism of particular importance to land locked ESA members whose principal transportation routes run through SADC configuration member states and whose retail sector are increasingly dominated by South African owned supermarket chains.

⁴² A provision already proposed by the ESA region.

⁴³ In many ESA countries competition in sugar supply is minimal, while the regulatory framework to prevent abuse of a dominant market position is gravely under-developed, this can lead to strong complaints from consumer and industrial users of sugar over the costs of sugar on local markets.

progressively introduce competition on national sugar markets to the benefit of consumers and processors?

Linked to this will be the tricky issue of the rules of origin to be established for sugar containing food products to be traded within the region. Some ESA members import sugar from outside of the region for use in export orientated food processing industries. Given the surplus sugar within the ESA region, consideration may need to be given to establishing rules of origin in intra-regional trade in sugar products which require the use of regionally produced sugar in sugar products traded intra-regionally under preferential trade arrangements. This is a tricky question, since under current circumstances it could disrupt existing export orientated value added food product production in certain ESA members. Nevertheless it would appear to be an issue which is better addressed up front rather than leaving it to the random adoption of safeguard measures which undermine the principles of free trade on which the COMESA is founded.

- Dealing with Sugar under EPAs

The EC's July 20th 2007 decision to adopt a proposal for a Council decision to denounce the sugar protocol with effect from the 1st October 2009, brings the inevitability of having to deal with future ESA-EU sugar sector relations in the context of the current Economic Partnership Agreements one step closer. The only final step remaining is the adoption by the EU Council of this European Commission proposal which is scheduled for September 2007. Thus, unless there is strong resistance to the EC proposal within the EU Council of Ministers, within a matter of weeks the sugar protocol as the basis for the conduct of ESA-EU sugar sector relations from October 1st 2009 will have been dismantled. This does not mean that ESA sugar protocol beneficiaries should simply accept this unilateral EU denunciation of the sugar protocol.

It would appear to require a dual track approach involving:

- a) an overall review of issues faced in the evolving context of the ACP-EU sugar trade (including trends in the evolving EU market, the consequences of EU reform measures, the structure of the EC's April 4th market access offer and the need to review the obligations entered into under the sugar protocol in the new and evolving context) and how to respond to these changes in ways which ensure a profitable future for low cost ACP sugar producers;
- b) taking the findings of this review into account in the concrete, regionally specific, responses integrated into the EPA framework.

In this context there is a need to shift the current debate to a detailed discussion of what is required to **ensure ACP sugar producers are effectively assisted in responding to the new market realities created by the wide ranging process of change underway**. The EC's current bland assertion that the denunciation of the sugar protocol forms "*part of the process of the EU enhancing its market access for ACP countries in the context of EPAs*", is simply not adequate as a response given the profound nature of the changes

underway. There is **absolutely no evidence** that the renunciation of the sugar protocol will meaningfully “enhance” the market situation of ACP sugar suppliers. Indeed all the indications are that **the majority of ACP sugar exporters will face extreme difficulties in maintaining their sugar trade with the EU**, following the outcome of reform and the renunciation of the sugar protocol. The new economic realities facing ACP sugar exporters need to be recognized and addressed.

While in the short term the ESA region is one of the least affected ACP regions, it does include some of the countries which will be most severely affected. However in the medium to long term it is likely that all ESA sugar producers will be profoundly affected, some directly as a consequence of EU policy changes and some more profoundly by the regional knock-on effects of these changes. This reality needs to be concretely highlighted.

It will not be sufficient simply to criticize the EC/EU position. What EU member states will be looking for is a constructive way out of the impasse faced. This will require individual ESA Governments and the region as a whole, to put forward constructive ways out of the dilemmas faced, within the framework of the broad trajectory of the internal process of CAP reform and the broad parameters of the EU policy response, both in an ACP context, but also importantly, with reference to the internal EU process of extending restructuring support

This will require a very careful articulation of the policy responses from the EC which ACP sugar exporters are looking for. There is currently a small window of opportunity for putting forward the ESA regions preferred policy response, notably during the final stages of the EPA negotiations. In order to create a receptive environment for these suggestions immediate emphasis should be placed on ensuring that a **stable and transparent** basis for future sugar sector trade relations is established *before* the denunciation of the sugar protocol.

The aim of the policy responses advanced should be to:

- a) **guarantee** a minimum level of expanded duty free access for **all** ESA sugar exporters (above and beyond the current level of exports) from 2008, based on the projected expansion of EU exports between 2006 and 2008, so as to ensure maximum advantage is taken of the additional value to be had on the EU market for as long as this additional value remains
- b) address the dangers of a potentially damaging “free-for-all” amongst ACP sugar suppliers in the context of the erosion of the price guarantees against the background of increased import volumes and finite dedicated cane sugar refining capacity (via the establishment of a minimum import price system for ACP sugar);
- c) ensure the necessary resources are made available to facilitate the delivery of ACP sugars to the EU market at remunerative prices, by directing a certain proportion of internal restructuring aid to establishing the necessary

infrastructure for delivery of expanded volumes of sugar to new market components;

- d) ensure low cost loans are made available to support the necessary production adjustment investments in ACP countries required to serve these new market components opening up in the EU, in a context where the uncertainties generated by EU sugar sector reform is increasing the costs of local financing for sugar sector related investments;
- e) ensure aid for trade support includes a focus on targeted measures designed to minimize the income losses per tones of sugar exported to the EU arising from the process of EU price reductions;
- f) equip ACP exporters to be able to effectively identify and serve higher priced components of the EU sugar market, so as to balance in part the effects of the removal of the EU intervention agencies role as ‘buyer of last resort’.

Developing Programmes to Minimise the Income Loss Effects of EU Price Reductions

EU sugar markets are becoming more sophisticated and more differentiated in line with income growth and changing trends in food consumption. By equipping ACP suppliers to more effectively serve these more sophisticated and differentiated markets the income effects of EU reductions in the raw sugar price can be minimized. This can be illustrated by considering the income effects for smallholder farmers of a sustained effort to develop the “fair trade” sugar market and in parallel promote the wide spread “fair trade” certification of smallholder producers associations.

Currently the “Fair Trade” Premium on sugar imported into the UK market from Malawi is US \$ 60 per tonne. In certain Southern and Eastern African countries, at current rates of exchange, this represents an amount equivalent to over 30% of the sucrose price paid to smallholder sugar farmers. This more than compensates smallholder farmers for the impact of EU price reductions on the sucrose price paid to smallholder sugar farmers.

While currently the “fair trade” sugar market is small, the experience in the banana sector suggests there is enormous scope for growth in this market component, particularly as UK retailers seek to situate themselves as “ethical retailers”. If just two of the UK supermarket chains followed the example in the banana sector and converted to 100% “fair trade” sugar, a market for over 210,000 tons of “fair trade” sugar would be created. A level of demand capable of sustaining the smallholder sugar farming sector in eastern and southern Africa beyond the process of EU sugar sector reform.

In this context it is recommended that consideration be given to targeted actions in the following areas:

Transitional Issues

- Ensuring the transitional issues linked to the levels of additional market access to be granted LDCs and non-LDCs (and the basis for its

distribution) are clearly elaborated on the basis of the EC's own projected 36.66% expansion of EU sugar imports between 2006 and 2008, with this expansion being evenly shared across ESA members based on the level of their total sugar exports to the EU attained in 2006.

- Ensuring a minimum level of expanded access for individual ESA non-LDCs is guaranteed *before* the application of the automatic safeguard provisions can be invoked.
- Ensuring greater clarity is provided on the “*certain price level*” to be applied, with this being based on the market prices in the EU not the reference price and encompassing the use of a minimum import price regulation.

The ESA region should consider putting forward concrete proposals on how the foregoing issues should be resolved and actively lobbying EU member states around the proposed approach. The measures advanced should seek to provide guaranteed minimum levels of access for non-LDCs, above and beyond the access currently enjoyed, in keeping with the spirit of the EC's April 4th market access offer.

Aid for Trade and Restructuring Support Issues

- Ensuring effective ‘aid for trade’ support is extended to undertaking priority sugar sector **production adjustments; marketing adjustments and social adjustments**, including through targeted programmes of assistance to **market development**, the establishment of **low cost loan financing facilities** for sugar sector **production** adjustment⁴⁴, and **grant based support** for sugar farmers organizations to assist them in strengthening their position within the marketing chain, in the context of the radically changed market environment.
- Ensuring early and effective delivery of restructuring support, through the adoption of regional “best practices” in programme design and aid delivery, including where necessary the introduction of procedural changes to facilitate early aid deployment in support of national and regional priority actions (e.g. agreement to reimburse previous expenditures in mutually agreed priority areas, given the long lead time in EC decision making processes⁴⁵).
- Ensuring internal EU restructuring support is in part used to ensure the creation of new market opportunities for ACP sugar exports, at established

⁴⁴ In a context where market uncertainties are dramatically increasing the costs of bank financing for sugar sector related investments.

⁴⁵ This is very important given the ‘use of lose it’ approach the annual allocations under the EC's multi-annual indicative programme for ACP sugar sector adjustment support.

market prices, within the framework of the envisaged expansion of ACP/LDC sugar exports and the existence of finite dedicated raw cane sugar refining capacity in the EU, with a dialogue with European sugar sector stakeholders being supported on the future evolution of the EU sugar market.

Non-Tariff Issues

- Ensuring a dialogue takes place on the arrangements for the issuing of **sugar import licenses** from the beginning of 2010 in order to ensure that those ESA sugar sectors with no direct EU corporate engagement are not systematically discriminated against in the allocation of licenses.
- Ensuring all sugar related internal EU regulations are reviewed and where necessary annulled, if they create administrative barriers to trade in sugar or sugar containing products in the new more liberalized trading environment.
- Ensuring that the enhanced surveillance mechanism for high sugar content products is only applied to products which are **clearly** being exported for the purpose of circumvention of the basic sugar import regime, so that this enhanced surveillance mechanism does not become an obstacle to the development of value added sugar based product exports in the ESA region.
- Ensuring rules of origin for sugar containing products are reviewed so that no unnecessarily strict provisions are applied, which de facto constitute barriers to trade in high sugar content value added products.
- Ensuring a strengthening of local food safety compliance capacities so to avoid the emergence of SPS disputes on products within the sugar value chain.
- Ensuring rules of origin are established for EU exports of sugar containing food products which require such products to use only EU or ESA produced sugar.

Tariff Issues

- Ensuring that sugar and sugar containing products are treated as sensitive within the ESA tariff elimination offer, with appropriate **exclusions**, **“back loading”** and **safeguards** being established to facilitate the development of sugar based value added processing in the ESA region for national and regional markets.

ANNEX 1: SUGAR PRODUCTION, CONSUMPTION, IMPORT AND EXPORT DATA FOR THE ESA REGION (1999-2005)

ESA EPA CONFIGURATION PRODUCTION OF SUGAR, 1999 to 2005							
(Tonnes raw value)							
Country	1999	2000	2001	2002	2003	2004	2005
Burundi	23,000	23,500	20,000	20,000	22,000	22,000	23,000
Ethiopia	234,709	250,869	305,000	286,898	295,000	325,000	345,000
Kenya	512,262	436,938	377,440	537,226	448,489	561,765	531,540
Madagascar	85,000	70,000	50,000	32,253	26,818	26,468	27,300
Malawi	187,392	208,804	205,000	260,617	257,000	255,000	265,000
Mauritius	395,691	603,561	684,979	553,182	537,723	606,409	523,930
Sudan	635,269	679,850	718,831	743,554	685,869	789,077	727,781
Tanzania,	113,622	130,000	115,000	186,538	217,513	210,829	278,496
Uganda	137,000	130,000	140,000	160,000	180,000	190,000	195,000
Zaire-DRC	65,000	75,000	60,000	65,000	65,000	60,000	60,000
Zambia	210,000	190,000	199,278	232,755	229,757	245,310	247,729
Zimbabwe	583,358	571,289	548,172	565,283	482,309	456,121	429,655
ESA Total							

Source: Extracted from ISO Year Book for 2005

ESA EPA CONFIGURATION CONSUMPTION OF SUGAR, 1999 to 2005							
(Tonnes raw value)							
Country	1999	2000	2001	2002	2003	2004	2005
Burundi	23,000	23,500	23,000	25,000	26,000	27,000	29,000
Comoros	5,000	5,500	8,000	9,000	9,000	9,000	9,000
Djibouti	12,000	12,500	12,500	13,000	14,000	15,000	16,000
Eritrea	8,000	8,000	8,000	9,000	15,000	16,000	20,000
Ethiopia	198,542	246,365	240,000	210,826	260,000	295,000	305,000
Kenya	662,412	662,520	625,000	652,176	691,560	728,196	756,141
Madagascar	95,000	97,500	97,500	104,444	117,150	129,038	131,548
Malawi	137,195	126,644	140,000	145,000	150,000	155,000	160,000
Mauritius	42,356	41,527	43,647	42,569	41,250	42,364	39,332
Rwanda	3,000	3,000	10,000	11,000	11,000	11,000	14,000
Sudan	450,000	429,996	522,616	567,795	567,594	624,404	876,688
Tanzania	200,000	207,500	200,000	164,518	218,494	220,898	267,856
Uganda	150,000	155,000	160,000	180,000	195,000	210,000	225,000
Zaire-DRC	75,000	75,000	75,000	85,000	85,000	90,000	95,000
Zambia	115,000	145,000	102,447	115,598	104,170	115,062	94,974
Zimbabwe	375,999	373,714	305,381	335,068	314,960	311,127	294,714
Total ESA							

Source: Extracted from ISO Year Book for 2005

ANNEX 2

A Review of Announcements of Sugar Sector Investment Plans in Southern and Eastern Africa

Within the ESA configurations **Illovo** has also been a major investor in **Zambian** sugar production, with total Zambian sugar production in 2006 reaching over 250,000 tonnes up from 186,000 tonnes in 1999. In 2006 Zambia exported 38,500 tonnes of sugar to the EU (11,000 tonnes under the EBA), including 7,215 tonnes of speciality Demerara sugar⁴⁶. Overall press reports indicate that sugar companies in Zambia are planning to expand sugar production from 255,000 tonnes to 434,000 tonnes by 2010, with exports to the EU increasing from 38,000 tonnes to 229,000 tonnes. Alongside this expansion will come an increase in Zambia Sugar's own hydroelectricity generation. In addition recent press reports indicate interest from Spanish and Indian investors in developing a plantation with a capacity to produce a further 250,000 tonnes of sugar⁴⁷.

In **Malawi**, where Illovo is the sole miller, production has expanded from 207,801 tonnes in 2001 to 256,706 tonnes in 2005, when 43,000 tonnes was sold into the EU market. Investment has also been made in developing speciality sugars for export to the EU. In 2006 it was anticipated that Malawi would export 23,000 tonnes to the EU under the sugar protocol and 21,027 tonnes under the EBA initiative. Maximum production capacity in Malawi is estimated at 280,000 tonnes

In **Tanzania**, where Illovo and a combination of Mauritian and French investors are interested in developing production, it is envisaged that production will increase from 270,000 in 2006 and 440,000 tonnes in 2010 (on the back of a large scale increase since 1999 when production was 108,000 tonnes). While much of this envisaged expanded production could be absorbed internally to replace the 200,000 tonnes of sugar currently imported, profit maximisation considerations, across what is increasingly a regional industry, are likely to mean that a growing volume of this production will be exported to the EU under the EBA.

Meanwhile at the end of July 2007 Tongaat-Hulett announced plans to expand its production in **Zimbabwe** from 240,000 tonnes to 442,000 tonnes, an increase of over 200,000 tonnes. Tongaat-Hulett also announced that its production elsewhere in the region is expected to increase, but provided no details.

Even as far north as **Ethiopia** the government has announced plans to expand sugar production from 280,000 tonnes to a 1 million tonnes, although to date no firm foreign private sector investor has been mobilised in the realisation of these plans. Although this

⁴⁶ See Times of Zambia report at <http://www.times.co.zm/news/viewnews.cgi?category=12&id=1162878700>

⁴⁷ See Reuters report reproduced in the Hindustanti Times at http://www.hindustantimes.com/news/181_1720641_00020013.htm

being said in July sucrosenews. com reported that Ethiopia had attracted its first private investment in the sugar industry from a Pakistani base investor⁴⁸.

In January 2007 press reports covered the announcement that the **Sudan** intends to add a further 450,000 tonnes to its production capacity with the benefit of investment from the Gulf region⁴⁹. Subsequently even more ambitious plans have been announced in July press reports indicated the Sudan plans to produce 10 million tonnes of sugar per annum by 2015 up from 850,000 tonnes currently. This will take place under 13 new projects which are expected to create 700,000 new jobs. Significantly a spokesman for Kenana Sugar Company indicated that Sudan's extra sugar production will most likely be sold to Arab, African and internal Sudanese markets⁵⁰.

In **Mozambique** there has been a major surge of investment by the South African based sugar companies **Illovo** and **Tongaat-Hulett** and significant investment from **Mauritian** sugar interests in **Sena Sugar**. In February 2007 Tongaat-Hulett announced plans to expand its sugar production in Mozambique from 115,000 tonnes to 270,000 tonnes by 2009, with a Rand 1.3 billion expansion of milling and cane production at its Xinavane and Mafambisse mills. Mozambican sugar production has risen from 44,000 tonnes in 1999 to 265,000 tonnes in 2005, with in 2006 Mozambique exporting the highest volume of sugar since independence at 175,837 tonnes. Production is expected to reach 292,000 tonnes in 2007 and around 500,000 tonnes by 2012.

⁴⁸ See (source from July MR)....

⁴⁹ See press report Brazil-Arab News Agency -30/01/2007)
<http://www.anba.com.br/ingles/noticia.php?id=13637>

⁵⁰ See.... Source from July MR)....