



Trade Hot Topics

Trade Policy Issues for a Regional Sugar Market in CARICOM

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Background

Reform of the EU sugar policy on 1 October 2017 will result in sugar prices within the EU aligning more closely with world prices. This will lower income for industries that have preferential access to this market, including producers within the Africa, Caribbean and Pacific (ACP) regions. Creation of an integrated sugar market within CARICOM, with the implementation of a common external tariff (CET) on all sugar imports, is one way to support regional sugar industries in the future. The reason Caribbean sugar industries will continue to require support following EU policy reform is that they cannot compete at world prices, which are extremely volatile.

The high cost of producing sugar in the Caribbean stems from modest levels of productivity, which are limited by the region's tropical agro-climate (and the growing effects of climate change) and the small scale of factories. Productivity is low by international standards in both field and factory operations, and this inflates producers' costs. This is true especially when compared with Brazil, the price-setter in the world market.

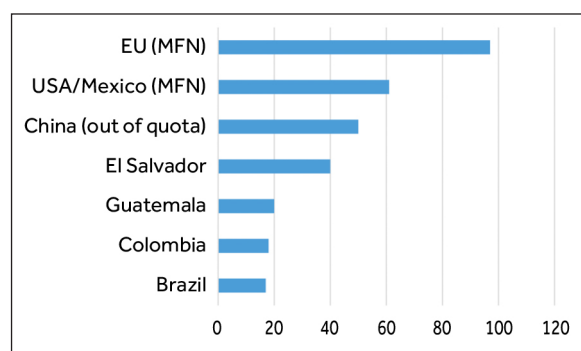
Against the looming backdrop of a transformed EU sugar regime, this issue of *Commonwealth Trade Hot Topics* assesses the potential for an integrated regional sugar market in CARICOM and outlines some of the trade policy reforms that would be needed to capitalise on this potential, as well as issues arising.

Rationale for an integrated regional sugar market

The challenging nature of the world sugar market means almost all sugar industries receive government support. This support takes many forms, including direct fiscal transfers to the agriculture sector (e.g. in the EU) and price support in local markets through the use of import tariffs. Given that few governments can afford to sustain direct transfers, the overwhelming majority use the latter.

Figure 1 displays the level of duties applied on imports of raw and white sugar in selected industries. The countries include those to which Caribbean producers sell sugar under preferential arrangements (EU and USA). The figure also includes some other major producers, such as Colombia and Guatemala, which are the two largest white sugar exporters to the Caribbean.

Figure 1: Duties applied on raw and white sugar in selected countries



Source: LMC trade database.

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The challenge for the Caribbean is that sugar-producing countries' domestic markets are small in relation to their sugar output. However, a CET around CARICOM offers the potential to support prices for up to 60 per cent of regional sugar output. A CET currently applies only on raw (brown) sugar, as producers within CARICOM are unable to produce sufficient white sugar to meet the needs of (mainly industrial) users within the region. Users of white sugar are typically granted waivers that allow them to import sugar duty-free. However, without effective implementation of a CET on white sugar, investment in white sugar production will not happen.

A CET on refined sugar would increase the price of sugar sold within CARICOM, ultimately to be borne by consumers. Governments would potentially also lose revenue to the extent that they currently apply a levy on white sugar imports. Regional sugar producers would gain from consumers' and governments' loss. A CET on refined sugar would also create transfers between CARICOM Member States, as there are many sugar-consuming countries that do not produce sugar. Support for the implementation of a CET therefore requires political judgement, and would have to be agreed by the governments of the CARICOM Member States.

The remainder of this Trade Hot Topic presents an overview of the CARICOM sugar market, the changes that would have to be made to create an integrated sugar market and the issues and challenges this raises.

The CARICOM sugar market

CARICOM's sugar balance

Annual sugar production in CARICOM has averaged around 500,000 tonnes, raw value, in recent years. This is higher than its sugar demand of around 300,000 tonnes, excluding Haiti, which is not a member of the Caribbean Single Market and Economy. If Haiti were to become an active member, this would bring total consumption within CARICOM in line with production.

Despite the regional production surplus, Caribbean countries import approximately 200,000 tonnes of sugar from outside the trade bloc. The reason for this stems from the fact that CARICOM sugar

producers have long benefited from preferential access to high-priced sugar markets in the EU and USA. In most years, they have exported 75–80 per cent of their output to these markets, overwhelmingly as raw sugar. In the absence of a CET on refined sugar imports, most refined sugar has entered regional markets duty-free. The result is that returns from exporting raw sugar to the high-priced markets of the EU and the USA have typically exceeded those that could have been earned from selling refined sugar within CARICOM. This has meant there has been no incentive to invest in the production of refined sugar. The region's refined sugar needs are thus met entirely through imports from outside the trade bloc.

In the absence of regional refining capacity, all sugar produced within the bloc is brown sugar, most of which is sold as bulk raw for refining in the EU and the USA. However, some locally produced sugar is produced as food-grade and is bagged for sale in regional markets. This sugar is predominantly for household use, as it does not always meet the quality requirements of industrial users (food and beverage producers), some of which require white or refined sugar.¹ White sugar that such users require must therefore be imported.

Imports of white sugar have been 150,000–200,000 tonnes annually in recent years. This represents around half of the total sugar demand in CARICOM. By far the biggest sources of white sugar imports are Colombia and Guatemala, which supply 80–90 per cent of CARICOM's needs in most years.

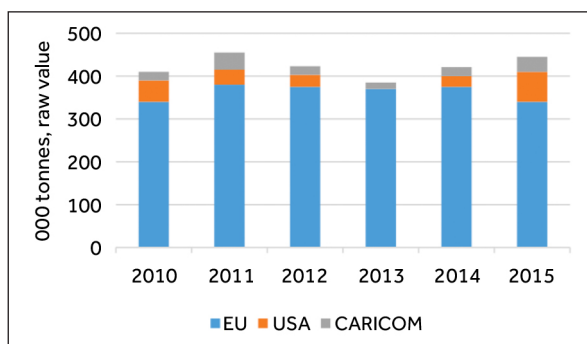
Figure 2 provides some insights into the destination of CARICOM's exports:

- Between 2010 and 2015, an average of 360,000 tonnes per year was sold to the EU (around 70 per cent of production) under the CARIFORUM Economic Partnership Agreement.
- Exports to the USA are duty-free but are limited by tariff rate quotas. Quantities are smaller, at 30,000–50,000 tonnes in most years. In years when the EU has offered better returns, no sugar has been shipped to the USA.
- Exports of brown sugar to other CARICOM members are modest, at 20,000–40,000 tonnes per year.

¹ The terms 'white' and 'refined' are often used interchangeably. However, not all white sugar is actually refined. This is because white sugar, which is typically defined by its colour and/or polarity, can be produced directly from cane juice. Such sugar is commonly referred to as 'plantation white sugar'. Capacity to produce plantation white sugar within CARICOM is very limited. Refined sugar, meanwhile, must first be crystallised as raw sugar and then pass through an additional refining process. The resulting output is also white sugar but of higher quality (lower colour/higher polarity) than plantation white sugar.

- Producers sell only 80,000–90,000 tonnes of sugar (around 20 per cent of output) each year in their domestic markets.

Figure 2: CARICOM exports by destination (2010–15)



Source: LMC trade database.

Molasses

Given that sugar consumption within CARICOM is stable, its current production surplus of around 150,000 tonnes will not decline unless there is further contraction of production within the region. One possible outlet for surplus sugar is in molasses. Today, the region is a sizeable importer of molasses to meet the needs of rum producers. If a higher CET were applied to molasses, then producers could choose to leave some sugar in molasses if the value of this sugar were greater than that which they can earn from selling the sugar to the world market. In this way, they would, in effect, sell more sugar within CARICOM (in the form of sugar-rich molasses) at the expense of molasses imports. This would inflate costs for the rum industry and therefore represent a transfer from this sector to sugar producers.

Production, trade and consumption trends

Four CARICOM sugar-producing countries remain: Barbados, Belize, Guyana and Jamaica.

With approximately 200,000 tonnes per year, Guyana is the biggest producer. The majority of its output is destined for the EU. However, GUYSUCO also sells sugar in the local market and has developed sales to other CARICOM markets. This has been facilitated by investment in a packing facility.

Jamaica was, until very recently, the second largest producer in CARICOM. It sells brown sugar locally and regionally, and also exports raw sugar for refining to the EU and the USA.

Production in Belize has expanded, in part because of the opening of a second mill in the country in 2015. This expansion has driven an increase in exports. However, the vast majority of exports

are of raw sugar for refining; the country exports less than 5,000 tonnes of brown sugar to other CARICOM countries.

Production in Barbados has contracted to less than 10,000 tonnes, much of which continues to be exported to its preferential markets.

When aggregating brown and white sugar consumption, two markets – Jamaica and Trinidad and Tobago – account for close to 60 per cent of total consumption in the bloc. Aside from these two countries, Guyana and Suriname are the only other markets where annual consumption exceeds 20,000 tonnes.

Current CARICOM sugar trade policy

CARICOM currently applies a CET of 40 per cent on raw and brown sugar imports from outside the bloc. The CET on brown sugar applies because regional production potential meets the 70 per cent threshold of regional demand. Nevertheless, there are concerns within the industry that not all CARICOM members apply the CET rigorously.

There is also provision for the application of a 40 per cent CET on refined sugar, but this is not applied because there is no refining capacity within CARICOM. However, there is also limited capacity to produce plantation white sugar that has the potential to substitute for a large part of the market that is currently supplied with imports of refined sugar. Given the much lower investment needed to produce plantation white sugar compared with refined sugar, producers are looking actively at the former. However, combined potential output of plantation white sugar is currently small in relation to the 70 per cent threshold required for implementation of the CET.

In the absence of a CET on refined sugar, governments typically grant licences for users of refined sugar in manufactured goods to import white sugar duty-free. The rationale for this is that imports do not compete with sugar produced within CARICOM.

Trade policy reforms to enhance regional integration

The logic for the current structure of CARICOM tariffs in sugar imports reflects the fact that local producers can meet regional demand only for brown sugar and not for refined sugar. This has two unintended consequences.

First, it suppresses demand for locally produced brown sugar. This is because, if sellers of brown sugar price their sugar close to the duty-paid cost

of importing brown sugar from outside CARICOM, then it is more costly than imports of reduced-duty or duty-free refined sugar. This encourages consumption of refined sugar over brown sugar, thereby suppressing demand for locally produced brown sugar. Moreover, some licensed imports of refined sugar that is imported duty-free for industrial use leak into the retail sector, further undermining demand for brown sugar,

Second, it discourages investment in refining capacity because the CET on refined sugar is not applied unless sugar produced within CARICOM can meet at least 70 per cent of demand for refined sugar. This creates a 'chicken and egg' situation, because investment in refining capacity will not occur in the absence of the CET and the CET will not be applied without investment in refining capacity.

The commercial impact of these consequences has been limited to date as a result of access to high-priced preferential markets, in particular the EU, which provides unlimited access for CARIFORUM members. However, erosion of value in the EU market following the reforms in October 2017 will expose these issues, because the regional market for brown sugar is smaller than it otherwise would be and producers have not invested in capacity to supply at least 70 per cent of the regional market for white/refined sugar.

If CARICOM governments decide to support regional sugar producers via protection of the regional sugar markets – that is, to create welfare transfers from sugar consumers to sugar producers – then effective implementation of the current duty on brown sugar and introduction of the CET on refined sugar will be necessary. Creating an attractive commercial environment for investments to produce plantation white and/or refined sugar will allow producers to access their local and regional sugar markets by displacing imports.

Issues arising for policy-makers

A significant change of tariffs raises the risk of unintended consequences. It will also be met with objections by sugar users and consumer groups. It is important therefore that these are understood and measures are taken to minimise their impacts. Some of the issues are highlighted below.

Rules of origin

The objective of implementing the CET is to raise the price at which refined sugar can be sold within CARICOM. Today, for example, the world price of refined sugar is approximately US\$500 per tonne. If

a duty of 40 per cent were applied, then the landed cost of imported refined sugar would be at least \$700/tonne (\$500 * 140% plus the cost of shipping, handling, insurance, etc.).

However, it would be possible to ship raw sugar produced within CARICOM to, say, the USA, where it is refined at a coastal refinery and then shipped back to and sold in a market within CARICOM. If the process of refining does not add sufficient value to change the origin status of the sugar, then the refined sugar could enter CARICOM duty-free. At today's world price of raw sugar of US\$400/tonne, the landed cost of the refined sugar would be approximately \$500–600/tonne (\$400 plus \$150–200/tonne for the costs of logistics to and from the US and the cost of refining the sugar in the USA).

Although the calculations presented above are only illustrative and will vary according to market conditions, they nevertheless highlight a potential loophole that could undermine the value of the CET if the Rules of Origin relating to refining and indicates the importance of aligning these rules with the principle intended by this support measure.

Sugar-containing products

Food and beverage manufacturers in the Caribbean are currently able to import refined sugar with little or no duty and are therefore in a strong position to compete with imported sugar-containing food products. Implementation of a CET on refined sugar would raise the cost of the sugar they use in their products. Unless measures are taken also to levy a duty on the sugar that is contained within the competing imported products, the competitive position of local manufacturers will deteriorate. This could have two effects. One is that such local manufacturers will lose market share to imports, resulting in the loss of business activity within CARICOM, along with impacts on employment and regional demand for sugar. Another is that, if the value of sugar in a product is sufficiently great, they may relocate outside CARICOM to somewhere where they have access to cheaper sugar, with a similar impact on business activity, employment and regional demand for sugar.

To prevent either outcome, CARICOM could consider levying a duty on imports of sugar-containing products (SCPs) that is commensurate with the sugar content of the product. In the EU, for example, the sugar duty is applied on most imports of SCPs based on the sugar content of the product. Different systems apply in different countries,

and not all countries apply duties on the sugar contained in SCPs. However, failure to do so risks loss of business activity within the Caribbean, as well as of demand for sugar. As such, it could reduce the amount of support the CET would provide to regional sugar producers.

Implementation of a CET on SCPs could also generate an additional source of government revenue.

Sugar quality

Many sugar users claim they require refined quality sugar and their manufacturing specifications prevent them from using lower-quality plantation white sugar. In reality, in many markets, manufacturers of most products, including multinational companies producing frontline brands, can and do use non-refined sugars. In such circumstances, bottlers, for example, may have to install systems to upgrade the quality of sugar before it enters the production process. However, the practice is widespread and, while it has a cost that may be reflected in the price that they pay for their sugar, it rarely prevents them from manufacturing their products.

There are some exceptions, notably for certain pharmaceutical products. However, these make up a very small share of total industrial demand for sugar. So, if exemptions have to be made in such exceptional cases, this will have only a limited impact on total demand for regionally produced sugar.

Surveillance

Implementation of a CET on refined sugar would create additional requirements for surveillance. However, these would be minimised if the CET were applied to all sugar, regardless of its quality. This would remove the need for checking/testing of sugar for quality. However, it would not remove the need to monitor the origin of sugar imports in order to distinguish between sugars originating within CARICOM and those sourced outside the bloc.

Moreover, if imports of SCPs are also subject to a CET, they too would have to be monitored. The large number of SCPs means careful consideration must be given to the way the SCPs are assessed for their sugar content.

Timing

Reform of sugar policy in the EU is imminent; implementation of the CET, investments in white sugar production capacity and necessary adjustments by manufacturers of SCPs will take longer. Careful consideration must therefore be

given regarding the timing of implementation, including the date that is set and whether the duty should be phased in. Whatever the decision, policy must be clear and binding if investors are to receive the assurance they need to make investments.

International Trade Policy Section at the Commonwealth Secretariat

This Trade Hot Topic is brought out by the International Trade Policy (ITP) Section of the Trade Division of the Commonwealth Secretariat, which is the main intergovernmental agency of the Commonwealth – an association of 52 independent states, comprising large and small, developed and developing, landlocked and island economies – facilitating consultation and co-operation among member governments and countries in the common interest of their peoples and in the promotion of international consensus-building.

ITP is entrusted with the responsibilities of undertaking policy-oriented research and advocacy on trade and development issues and providing informed inputs into the related discourses involving Commonwealth members. The ITP approach is to scan the trade and development landscape for areas where orthodox approaches are ineffective or where there are public policy failures or gaps, and to seek heterodox approaches to address those. Its work plan is flexible to enable quick response to emerging issues in the international trading environment that impact particularly on highly vulnerable Commonwealth constituencies – least developed countries (LDCs), small states and sub-Saharan Africa.

Scope of ITP Work

ITP undertakes activities principally in three broad areas:

- It supports Commonwealth developing members in their negotiation of multilateral and regional trade agreements that promote development friendly outcomes, notably their economic growth through expanded trade.
- It conducts policy research, consultations and advocacy to increase understanding of the changing international trading environment and of policy options for successful adaptation.
- It contributes to the processes involving the multilateral and bilateral trade regimes that advance more beneficial participation of Commonwealth developing country members, particularly, small states and LDCs and sub-Saharan Africa.

ITP Recent Activities

ITPs most recent activities focus on assisting member states in their negotiations under the WTO's Doha Round and various regional trading arrangements, undertaking analytical research on a range of trade policy, emerging trade-related development issues, and supporting workshops/ dialogues for facilitating exchange of ideas, disseminating informed inputs, and consensus-building on issues of interest to Commonwealth members.

Selected Recent Meetings/Workshops Supported by ITP

5 May 2017: Making UK Trade Work for Development Post-Brexit, Expert Group Workshop held in Oxford, United Kingdom in collaboration with the Blavatnik School of Government.

21 - 22 March 2017: Ad Hoc Intergovernmental Expert Meeting: Trade-related Fisheries Targets under Sustainable Development Goal 14, held in Geneva, Switzerland in partnership with UNCTAD, FAO, UNEP, ACP, IOI.

10 March 2017: Commonwealth Trade Ministers' Roundtable Meeting held in London, United Kingdom.

10 - 12 November 2016: Workshop on Productive Capacity and LDC Graduation, held in Beijing, China in partnership with UN DESA and Peking University.

1 - 2 November 2016: Update of Post-Nairobi and Preparation for MC 11, held in Port Vila, Vanuatu in partnership with WTO, EIF and PIFS Secretariat.

27 - 28 September 2016: Implementing the Sustainable Development Goals and Achieving Inclusive Trade, WTO Public Forum, held in Geneva, Switzerland.

21 July 2016: Fostering Green Economies through Trade, Investment and Innovation, UNCTAD 14, held in Nairobi, Kenya.

27-29 May 2016: Tracking Progress and Acceleration Transformation, LDC IV Monitor, held in Antalya, Turkey.

12 - 13 May 2016: Caribbean Regional Consultation on Recent Developments in Trade, held in Port of Spain, Trinidad and Tobago.

10 - 12 May 2016: Oceans Economy and Trade: Sustainable Fisheries, Transport and Tourism, held in Geneva, Switzerland.

Selected ITP Publications

Vickers B. (2017). *A Handbook on Regional Integration in Africa: Towards Agenda 2063*. London: Commonwealth Secretariat.

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Srinivasan, T N (2009). *LDCs, Landlocked Developing Countries and Small States in the Global Economic System*. London: Commonwealth Secretariat.

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Winters, L. A. et al. (2009). *An EU-India Free Trade Agreement: Reflections on the Implications for Excluded Countries*. London: Commonwealth Secretariat.

Cali, M. and te Velde, D.W. (2008). *Towards a Quantitative Assessment of Aid for Trade*, Economic Paper No. 83. London: Commonwealth Secretariat.

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