

Beyond EU Sugar Reform: Financing Diversification in ACP Sugar Exporting Countries

by Edwin Laurent¹

1. Introduction

The export of cane sugar to the European Union by several ACP countries and India has been facilitated by special guaranteed arrangements enshrined in the Sugar Protocol. The secure earnings from this trade have contributed to stability of rural incomes and in several of the countries sugar exports have been the foundation for national economic growth and development. However, threats to the regulatory basis on which this trade operates are now emerging which can place in jeopardy the income and employment contribution of the industry.

A decline in the industry will necessitate economic adjustment entailing the introduction of replacement income and employment generating activities, in order to safeguard living standards and growth and development prospects. This paper examines the nature of the current marketing system, the likely threats and their impact and based on the lessons of the recent experience of EU financial assistance to ACP banana exporters, notably the Windward Islands,² makes recommendations for approaches to providing external support for economic diversification in the ACP Sugar Protocol Members.

2. The Sugar Protocol

The Sugar Protocol, originally signed on 28 February 1975, committed the European Communities (EC) “for an indefinite period to purchase and import, at guaranteed prices, specific quantities of cane sugar, raw and white which originate in the ACP States and which these States undertake to deliver to it.”³ This arrangement has boosted the development of the sugar industry in ACP States and provided the beneficiary countries with guaranteed market access at predictable and stable prices, which for several years have been significantly in excess of world market prices. The latter have, in general, been too low to cover costs of production and offer a remunerative return to ACP producers. Between 1990–2001, average EU prices were 61.14 US cents/kg as opposed to a 22.20 US cents/kg on the world market.⁴

¹ Prepared for the Commonwealth Secretariat by Edwin Laurent, former Ambassador to the European Communities for the Eastern Caribbean States (Dominica, St. Kitts and Nevis, Saint Lucia, St. Vincent and the Grenadines and representative of the British Virgin Islands). The views expressed are not necessarily shared by the Commonwealth Secretariat.

² Commonwealth of Dominica, Grenada, Saint Lucia and St Vincent & the Grenadines.

³ Protocol 3 of the ACP-EU Partnership Agreement, Cotonou, Benin, 2000

⁴ Milner C. R. and Morgan L.W. “The impact of the ACP of the reduction by the EU of import export subsidies on Sugar”

The key elements of the Sugar Protocol from its Members' standpoint are therefore the guaranteed purchases of a fixed quantity of sugar (1.3 million tonnes from ACP and India) and the annually "negotiated" price, whose level is to be "*within the price range obtaining in the community taking into account all relevant economic factors.*" The preferential arrangements for the ACP and India are part of a broader structure, the Common Market Organisation (CMO) for sugar in the EU. This system also encompasses a production quota scheme, guaranteed price and intervention mechanism, export refund programme and production levies operating within a unified and interlinked structure. If for whatever reason changes in the character or operation of the Sugar Protocol result in significant price declines, exporting countries will be obliged to reduce costs of production, find new sources of replacement income or both.

(a) Threats to the Protocol

Whilst the legal integrity of the Protocol has never been challenged, its ability to continue to provide prices which are sufficiently remunerative is under threat since it is part of the EU's CMO, whose reform is being forced by both internal and external pressures, the latter coming principally from the mandate set out in paragraph 13 of the WTO Doha Ministerial Declaration of 14 November 2001.

Negotiations had already been launched in the WTO since 2000 under Article 20 of the Agreement on Agriculture,⁵ but were given new impetus when, in the following year, Ministers launched the Doha Development Agenda with its ambitious plan for agriculture to "*establish a fair and market-orientated trading system through a programme of fundamental reform encompassing strengthened rules and specific commitments on support and protection in order to correct and prevent restrictions and distortions in world agricultural markets.*" Based on that objective Ministers, in their Declaration, committed to "*Comprehensive negotiations aimed at: substantial improvements in market access; reductions of, with a view to phasing out all forms of export subsidies; and substantial reductions in trade distorting domestic support.*"⁶

Even as these negotiations were proceeding, Australia and Brazil on 27 September 2002 filed a complaint in the WTO alleging that export subsidies in excess of the EC's approved ceilings were being granted and that the provision of the guaranteed intervention price, since it is available only to domestic producers, violates the national treatment provisions of GATT Article III. The complaints were followed by fruitless consultations and eventually a Panel, the "European Communities - Export subsidies on sugar" which was established on 29 August 2003 by the WTO's Dispute Settlement Body and composed on the 23rd December of the same year with Thailand joining in as a complainant. The confidential report of the Panel was presented to the Parties in the first week of August 2004. According to press reports, the Panel has found in favour of the complainants.

Future reform of the CMO for sugar is clearly inevitable and can be forced on the EC both by the final outcome of this dispute and of the WTO Agriculture negotiations.

(b) Reforming the EU Common Market Organisation for Sugar

Anticipating pressures and obligations to "liberalise", the EU Commission, in July 2004, announced plans for reform of the CMO. In a communication to the European Parliament on the 14th of that same month, the Commission proposed: "*A significant reduction in two steps of the institutional support price for EU sugar with the abolition of intervention and the introduction of a reference price. This reference price will serve in the establishment of the minimum price of sugar beet producers, the trigger level for private storage, the level of border protection and the guaranteed price under the preferential import mechanism.*" It also noted that: "*In addition, the proposal will provide the basis for initiating a structured dialogue with EU partners in the developing world on the sugar sector, in order to consider the manner in which the EU can best contribute to necessary and inevitable adjustment in sugar production in African, Caribbean and Pacific countries (ACP) and India.*"

Specifically the Plan, which should start from July 2005 and be implemented over 4 years with a review in 2008 will "*Substantially cut back sugar exports and export refunds, abolish intervention, reduce EU production*

⁵ "Continuation of the Reform Process" Article 20; WTO Agreement on Agriculture; Marrakesh 15th April 1994.

⁶ Doha Ministerial Declaration, 2001.

and the informal sugar price and grant a de-coupled payment to sugar beet farmers". According to the impact projections of the Commission, support prices will drop by 33% over three years with the final implied raw sugar price falling to •329 per tonne.

The negative economic consequences of such a major fall in prices and hence revenue will be considerable. (There will be no increase in overall volume since the country allocations under the Protocol are fixed). The Commission has confirmed that it will assist the Protocol countries and India to adapt to the new market conditions with programmes for improving the competitiveness of the sugar sector, where it is economically viable, and provide support for diversification, when improvements in competitiveness in the sugar sector are not sustainable.

(c) Consequences for the ACP Sugar Protocol Members

The sugar industry dominates the economy of most of the ACP supplying States. The following table summarises the sugar sector's contribution to foreign earnings and employment in various ACP countries.

Table 1: Contribution of sugar to employment and foreign exchange.

Country	Year	Contribution to Foreign Earnings		Share of Employment	
		% of agricultural exports	% of total exports	% of employment in agriculture	% of total employment
Barbados	2001	100%	12.5%	52.6%	1.8%
Belize	2001	22%	19.6%	51.2%	14.1%
Fiji Islands	2001	67.4%	23%	12.8%	7.3%
Guyana	2000	65.2%	22.6%	32.2%	9.7%
Jamaica	1999	48.7%	8%	16.4%	2.9%
Malawi	2001	11.2%	9%	5.5%	1.3%
Mauritius	2001	89.6%	19.5%	80.2%	6.4%
St. Kitts/Nevis	1999	92.3%	21.8%	58.27%	8.45%
Swaziland	2001	34.4%	9.4%	80.9%	8.6%
Trinidad & Tobago	2001	18.2%	0.6%	61.7%	4.8%
Zimbabwe	2000	7.6%	3.3%	7.8%	2.1%

Source: compiled from: Third Party Submission by the ACP Sugar Industries, to the WTO Panel. 18 March 2004.

The beneficiaries of the Sugar Protocol are all small economies and their very heavy dependence on the income from their sugar exports to Europe makes them particularly vulnerable since changes to the system which result in income loss or contraction of the industry are greatly magnified which can have severe consequences for the entire economy. The Technical Centre for Agricultural and Rural Cooperation based in the Netherlands has computed the likely impact on national earnings for ACP States of the reforms currently envisaged by the Commission. The table below summarises the projected loss of earnings in various ACP countries as a result of the reform of the EU sugar regime.

3. Experience of the Banana Protocol

Sugar is not the first ACP export commodity to come under threat placing at risk traditional income flows and rendering imperative the need to restructure and diversify in order to safeguard earnings and employment. The first such ACP commodity was bananas. Here the creation of the 1993 European Single Market and the subsequent GATT/WTO Disputes, prompted a still ongoing process of liberalisation of the banana market. The reforms and changes have resulted in lower prices for ACP

Table 2: Projected loss of earnings.

Country	Sugar Protocol quota (tonnes)	Current earnings euros (•523.70/t)	Earnings After Stage 1 reform (•329.0/t)	Income losses from reform euros
Belize	40,349	21,130,771	13,274,821	-7,855,950
Congo	10,186	5,334,408	3,351,194	-1,983,214
Ivory Coast	10,186	5,334,408	3,351,194	-1,983,214
Fiji Islands	165,348	86,592,747	54,399,492	-32,193,255
Guyana	159,410	83,483,017	52,445,890	-31,037,127
Jamaica	118,696	62,161,095	39,050,984	-23,110,111
Barbados	50,312	26,348,394	16,552,648	-9,795,746
Madagascar	10,760	5,635,012	3,540,040	-2,094,972
Malawi	20,824	10,905,528	6,851,096	-4,054,432
Mauritius	491,031	257,152,935	161,549,199	-95,603,736
St Kitts & Nevis	15,591	8,165,007	5,129,439	-4,313,432
Swaziland	117,845	61,715,426	38,771,005	-22,944,421
Tanzania	10,186	5,334,408	3,351,194	-1,983,214
Trinidad & Tobago	43,751	22,912,398	14,394,079	-8,518,319
Zimbabwe	30,225	15,828,832	9,944,025	-5,884,807

Source: "Agritrade," a publication of the Technical Centre for Agricultural and Rural Cooperation

traditional suppliers and in some cases, exports have consequently fallen sharply or even disappeared.⁷ Recognising that the traditional ACP exporters would be adversely affected, in terms of security of access and prices, by the creation of the Common Organisation of the Market in Bananas (COM), in terms of security of access and prices, the EU introduced the Special System of Assistance (SSA) in 1994 by Regulation 2686/94 which offered technical and financial assistance measures and income support for banana producers. The measures were aimed at increasing productivity (including through irrigation and drainage and renewal of plantations), product quality and marketing and encouraging diversification. The amount provided under the SSA was •78 million during the entire four year programme. This system was replaced in 1999 by the Special Framework of Assistance (SFA) established by EC Regulation 856/99. Under the SFA the income support component was abandoned. Funds averaging in the region of •45 million per annum have been used for a variety of projects covering field productivity improvements, institutional development and reform of the banana sector, diversification projects and the provision of social safety nets. In addition to the SSA and SFA, the ACP can, in certain circumstances also be eligible for compensation for loss of earnings under the Scheme for the Stabilisation of Export Earnings (STABEX) and more recently through the replacement mechanism for Financing Short-term Fluctuations in Export Earnings (FLEX).

A study by external consultants⁸ to evaluate the efficiency, effectiveness, impact and viability of the arrangements, concluded that the assistance had covered a broad range of initiatives and that its greatest impact on competitiveness had been where it involved improving productivity in the field. The study recommended that priority in future should be given to diversification. Steps were certainly taken to implement the recommendations, for whilst diversification projects accounted for 12% of SFA funds

⁷ Major losers have included Cape Verde and Madagascar which no longer export and the Windward Islands Surinam and Jamaica whose exports have declined tremendously.

⁸ Hubbard M, Herbert A and Roumain de la Touche/ Evaluation of EU assistance to ACP banana producers).

in 1999, by 2002 they were using up to 64% of the total. During the four years 1999 to 2002, out of a total of •176.18 million, the bulk of the funds, •118.33 million, nonetheless went into projects aimed at boosting productivity. Diversification projects were principally in the Windward Islands with Dominica accounting for •14.84 million, Saint Lucia •24.9 million, and Saint Vincent •6.10 million. Elsewhere, the only other major allocations to diversification projects were in Somalia •3.4 million and Jamaica •3.3 million. Actions to promote diversification were usually in the agricultural and rural development sectors.⁹

(a) Was the support effective?

The Windward Islands¹⁰ which received a substantial portion of the total assistance are the least diversified of the ACP suppliers, and despite the assistance provided have not made considerable progress in diversification.¹¹ In a 2003 Evaluation of the SFA, the UK based consultancy firm, Landell Mills Ltd highlighted various short-comings including unclear objectives, which permitted considerable influence of individual decision makers with negative consequences, unrealistic expectations and an ill-defined approach to diversification.

The banana dependent Windward Islands have several ongoing diversification projects in place supported by external funding since the early 1990s. By the end of the decade there was much greater enthusiasm and commitment but nonetheless the pace of actually getting the projects operational has been slow. This would have been due to a number of factors but it should off course be appreciated that it is only a few years since the serious acceptance of diversification as a policy imperative. Given that diversification in single commodity exporting countries is a long-term process it probably is too soon to expect dramatic results in the Windward Islands. However there might have been scope for more result oriented management of the process particularly assisting and encouraging investment in new areas of productive activity and ensuring the transmission of clearer market signals to entrepreneurs.

(b) Applying the lessons

The still ongoing experience of banana suppliers particularly in the Windward Islands to mobilise and apply EU funding for diversification provides a useful foundation not for replicating the experience of bananas but learning from it so as to avoid pitfalls and errors and building on its lessons. Maybe the most important lesson is the need for a genuine commitment in the country to economic diversification. This might seem superfluous but unless such commitment is present there will not be the consistency and adequacy of institutional support and facilitation needed for what will invariably be a particularly challenging enterprise. It must be appreciated that what is required is fundamental economic restructuring, not simply the selection and introduction of a replacement crop for sugar cane. The search has to be for new areas of productive activity in which the country has or can realistically expect to develop a comparative advantage. Such identification and development of new industries does not readily lend itself to management within an annual project cycle. Rather long term vision and programming are essential which must be realised within a consistent policy framework. Indeed the Commission has itself recognised this as essential and in its report to the European Parliament on the 23 December 2002 undertook to explore the possibility of devising multi-year action plans. This is a step in the right direction but the plan period needs to be long enough so as to be consistent with the requirements of the diversification process.

It was only recently that the focus of EU financial support for banana suppliers has been moving towards diversification and even so this has been principally in the Windward Islands. Elsewhere projects to boost production and productivity have dominated. In the case of sugar, diversification needs to be clearly identified from the outset as a priority for funding with the encouragement of private sector investment in new industries in which market signals indicate the existence of international competitive advantage.

⁹ Communication of the Commission and the European Parliament (2002) 763.

¹⁰ Except for Grenada which has a n historical trade in spices and cocoa.

¹¹ Gary Melville "Situational analysis of the Agricultural Sector of the OECS Member Countries". Dec. 2002

The diversification process is an essential component of the economic adjustment which must take place as a result of the envisaged declines in earnings from and employment in the sugar industry. To be successful it requires both a conducive institutional and policy framework as well as actual investment in new areas of productive activity.

(c) Impediments

The ACP sugar suppliers are all small developing economies sharing certain economic disadvantages which can have adverse consequences for their ability to rapidly and successfully adapt to market changes. The development of appropriate policies must therefore be informed by familiarity with the economic constraints which these countries face which can preclude the successful application of certain economic remedies.

The impediments which they face include:

- Labour market rigidities. Although there is surplus labour in all of the Protocol States there is inadequate flexibility in the labour force due to a lack of new and appropriate skills;
- Undeveloped capital markets which are not only ineffective in mobilising funds for investment but in general do not make risk capital available for new ventures on reasonable terms particularly to entrepreneurs who are not yet established;
- Foreign direct investment (FDI) has been a major source of financing investment particularly in manufacturing and the export service sector of developing countries, however with only two exceptions the ACP sugar exporters have not had notable success in attracting FDI despite a generalised improvement in their investment climate; and,
- The small size of the domestic market which obliges reliance on exports even in the current context of the decline of trade preferences and the intensification of international competition.

(d) The role of the Public Sector

The following contributions must be made by the Government:

1. Provide a predictable, stable and supportive environment for business (both local and foreign);
2. Provide institutional support and investment incentives, marketing and support for export, technology and quality improvement in support of new enterprises; and,
3. Promote the upgrading and adaptation of the labour force and of managers through adequate investment in appropriate technical education and skills training.

At the national level there needs to be clear commitment to diversification and the support of the Government for investment in new areas of productive activity to replace or compliment declining income and employment from cane sugar production and exports. A range of programmes will be required which will have to be administered by the public sector including training of managers and technicians and the provision of required infrastructure. A key role for Governments will be to devise and administer investment incentives and inducements that are coherent with its policy of diversification into new areas in which the countries have already existing or potential advantage. The signals sent to investors in existing and new industries, through incentives etc., must be rational and clear with no masking of market realities pertaining to international competitiveness. Incentives which promote investment will be essential but where the beneficiaries are in activities with no economic future, they will invariably prove counter-productive. For certain of these activities Governments will invariably require donor assistance.

(e) Assisting the investor

The reality in the ACP countries in question is that actual investment in new productive activities is in general principally undertaken by the private rather than the public sector. Even if the right signals and institutional and other support facilities are available, entrepreneurs, particularly in new or non-traditional activities often face severe obstacles, the most widespread of which is inadequate access to financing. This manifests itself in three ways:

1. Exorbitant cost of capital in terms of interest rates;
2. Repayment periods which are too short in relation to the project's income generation patterns;
3. Excessive collateral requirements.

External grant and concessionary funding can be used in such a manner as to overcome these impediments. The following proposal can provide a means of addressing these difficulties.

4. A proposal for financing of private sector diversification projects

In view of the following:

1. The substantial loss of earnings and employment envisaged due to the changes to the EU's CMO for sugar;
2. The high degree of national dependence on the industry in the ACP Protocol Members; and,
3. The inability of these countries on their own, to generate or mobilize the financing required for the adjustment and diversification process. Substantial external funding will be required to finance the needed investment.

Learning from SFA and SSA, it would be essential that from the outset there is a strong focus on investment in new productive areas in which market signals indicate an international comparative advantage. It is proposed that a substantial portion of the financing be made available as risk capital to the private sector for use in new and approved areas of productive activity via a rolling fund to be administered by the banking sector. Investors in new or expanding manufacturing or agricultural or qualifying service enterprises would be eligible for access to financing.

The following conditions are to apply:

1. Investment projects, and business plans are to undergo and pass rigorous appraisals for viability and sound management according to previously set and approved criteria;
2. Reasonable collateral requirements for loans are to be set at a level which provides adequate but fair banking safeguards but are not so high as to deny suitable investors the opportunity to obtain a loan. The aim here is to ensure that the investor has a genuine stake in the business and is not shielded from risk. In practice banking personnel are likely to require special training in risk assessment for such "non-traditional" business enterprises;

In order for actual investment to take place, it would be essential that funds are available to entrepreneurs on reasonable terms which do not preclude access except by projects with anticipated profitability way in excess of the norm. Hence:

- The loan repayment periods are to be appropriate for private investment projects, even if this necessitates longer durations than currently available;
- The rates of interest to apply on qualifying loans should be reasonable and appropriate for such projects even if this could necessitate there being substantially lower than those otherwise prevailing.

It will be necessary for the donors and the governmental authorities to ensure that this facility actually generates the required new investments. They should also ensure that the share (interest and charges) retained by the banking sector is limited to actual costs plus a reasonable margin and that the facility is operated in keeping with applicable WTO rules.

On first sight the provision of access to credit and risk capital on terms more favourable than currently available might conceivably be criticised as interfering with the working of the financial market. However, it should be recalled that a major impediment faced by current and potential investors in productive enterprises in the Windward Islands is that risk capital and credit are in general not available on suitable terms. If as this paper assumes, the banking policies, terms and conditions in the ACP sugar exporting States are not substantially more favourable than those in the Windward Islands, then on their own the banking sectors in those countries will not provide the required and adequate financing on acceptable terms for investments in new areas. Therefore, despite institutional and other support, adequate private sector investment in new productive enterprises essential for diversification, will not take place.

The existence of dual interest rates and lending policies is justifiable since the funds would be provided to the local banks at lower rates and on more favourable terms than those they themselves otherwise raise commercially. To permit on-lending at current rates of donor funds provided on a concessionary basis would constitute a perverse subsidisation of the financial intermediaries rather than the provision of support to investors.

The use of loans rather than grants is recommended since the latter, by shielding entrepreneurs from risk, would have weakened the pressures for sound and reasonable investment and managerial decisions as well as blurring market signals. These pressures on the investor and clarity of market signals are essential if choices as to areas for investment are in fact to be limited to those in which there is genuine anticipation of comparative advantage.

In the context of the severe economic impediments faced by the small economies dependent on sugar, the achievement of concrete results in diversification requires a pragmatic rather than an ideological approach.

5. Conclusion

The ACP sugar exporters will need considerable and multi-faceted external financial and other support for the adjustment of their economies as income and employment in the sugar industry declines. An essential component of the adjustment process will be diversification of their economies, but a most serious obstacle is the inadequacy of access to risk capital on affordable terms for entrepreneurs in productive enterprises. Unless this obstacle is overcome, diversification programmes will either fail or make unacceptably slow progress. In addition to the range of public sector and institutional support, priority attention needs to be paid to tackling this deficiency. The proposed risk capital facility is intended to do this. Once it is properly devised and efficiently managed it can address in a practical way one of the principal obstacles to investment in new productive enterprises, the inadequate access to credit and risk capital on affordable terms. When the abovementioned criteria are satisfied, this facility can be self-sustaining with minimal subsequent bureaucratic involvement.

Whilst various donor agencies should be approached for support in the adjustment process, the offer made by the Commission to initiate dialogue with the ACP sugar suppliers and to draw up tailor made programmes, needs to be seized upon so as to ensure that the programmes are consistent with national economic policies and that the scope and terms of support are adequate. Also it is for them to ensure that the funding and support programmes are devised and administered in such a manner that they can have real impact as intended. There is already experience with external support for adaptation and diversification of the banana sector, it would be in the interests of ACP sugar suppliers to learn from that record.

Subjects of the Previous Ten Issues of the Commonwealth Trade Hot Topics Briefs

Reform of the EU's Agricultural Policy

Rules of Origin: The Way Ahead

EU/U.S. Framework for WTO Agriculture Negotiations

The Cancun WTO Ministerial Meeting: A View from the Sidelines

South Africa's Trade Policy and Southern and Eastern Africa: Focus on SACU and SADC

EU Farm Subsidies and the interests of Developing Countries

UNCTAD XI: Issues Emerging and Lessons for Developing Countries

Proposed Reform of the EU Sugar Regime: More Market, Consumer and Trade Friendly

The Doha Work Programme: The New Framework

The WTO Telefonos de Mexico, S.A. de C.V. (TELMEX) Case: Outcome and Implications



Commonwealth TRADE HOT TOPICS

Produced by the Economic Affairs Division of the Commonwealth Secretariat.

For further information or copies, please contact:

Economic Affairs Division, Commonwealth Secretariat, Pall Mall, London SW1Y 5HX, UK

Tel: 020 7747 6231/6433 Fax: 020 7747 6235

Email: i.mbirimi@commonwealth.int or v.qalo@commonwealth.int