



ERS Report Summary

Economic Research Service

July 2008

U.S. Department of Agriculture



This is a summary
of an ERS report.

Find the full report at
[www.ers.usda.gov/
publications/err59](http://www.ers.usda.gov/publications/err59)

ERS is a primary source
of economic research and
analysis from the U.S.
Department of
Agriculture, providing
timely information on
economic and policy
issues related to agricul-
ture, food, the environ-

The EU Sugar Policy Regime and Implications of Reform

Aziz Elbehri, Johannes Umstaetter, and David Kelch

The European Union (EU) is one of the leading sugar producers and traders in the world. This position was built over time through the application of protectionist policies that regulated production, prices, exports, and imports. Since its creation in 1968, the existing EU sugar policy—commonly referred to as the Common Market Organization (CMO) for sugar—had changed only marginally. In 2006, however, a new sugar regime took effect, largely influenced by three factors: tariff- and quota-free access to least developed countries (LDCs) beginning in 2009, which would likely result in increased sugar imports; enforcement of World Trade Organization (WTO) commitments; and the accession of 10 new member states to the EU in 2004, which exacerbated preexisting sugar supply-and-demand imbalances.

What Is the Issue?

The EU sugar policy was reformed under multiple pressures, both internal and external. The reform package targeted a limited set of policy instruments, such as support prices and quotas, with the hope of improving the efficiency of the industry and making it more sustainable. However, the partial nature of the reform, which left several key policy interventions unchanged, raises concerns about the implications of the reform on the EU sugar industry and on international trade. Because the EU is the world's second largest producer and exporter of sugar and the third largest importer, the EU sugar reforms have important consequences for both global and U.S. sugar markets. This report examines the current EU sugar regime and uses a model-based approach to assess the potential market and trade implications of the implemented reforms.

What Did the Study Find?

Current sugar regime - The CMO for sugar is complex, encompassing a variety of policy instruments, including price support, production quotas (sugar and substitutes), export subsidies, and import barriers. The reforms targeted only a few of these instruments, principally cutting the intervention price, or the price guaranteed to EU producers. The 36-percent cut in the intervention price is designed to lower the market price and discourage sugar imports from LDCs. The reforms also included a voluntary buyout scheme for production quotas and a disallowance of exports of nonquota sugar, a step taken with the aim of reducing domestic production and bringing export subsidies within WTO limits.

The reforms did not address interstate quota trading (which could induce a significant shift in production from high- to low-cost regions), leaving in place, as before, national quota allocation. The reforms also retained production quotas on sugar substitutes (isoglucose, or high-fructose corn syrup), albeit at higher levels, preventing greater competition within the EU among different types of sweeteners.

www.ers.usda.gov

Model-based results - According to a model-based analysis of the reform, the combined effect of cuts in prices and production quotas will lead to lower EU sugar production, lower prices for consumers, and higher consumption. Moreover, when the prices of sugar substitutes go down, reducing the profitability of isoglucose production and, hence, its output, sugar consumption will rise. In all model scenarios, EU sugar exports decline as a result of a combination of lower production, lower export subsidies, and restrictions on exports of nonquota sugar. Consequently, EU sugar imports will have to rise to bring the market into balance.

When the model accounts for oligopolistic industry behavior, results show that EU sugar production will decline further than it would under the reform package's quota buyout scheme. Domestic market prices will not necessarily fall as much (or proportionally) as the cut in the intervention price, partly due to increased markups charged by sugar firms. Model results also show that EU sugar reform will lead to a significant exit of firms from the industry. This effect is consistent with the accelerated restructuring and consolidation of EU sugar processors that has been observed in the period following the reforms.

Market and trade implications - The analysis suggests that, given the market structure of the EU sugar industry, cutting the intervention price alone may not have the desired effect on production and market prices. The reform's impact on production and prices will likely depend more on how much sugar is actually removed from the market, which will be partly determined by the extent of the sugar industry consolidation currently under way. A more complete sugar sector reform that included lower import barriers (outside preferential agreements), interstate quota tradability, and greater market opportunities for sugar substitutes would have weakened oligopolistic behavior, thus having the potential to make the industry leaner and more competitive.

The reform's trade effects are more significant for preferential than for nonpreferential exporters to the EU. The near concurrent implementation of tariff-cutting measures in 2009 and the sugar reform in 2006 will dampen potential gains for LDCs with preferential access to the EU as they face greater competition from third-country (nonpreferential) exporters. Preferential exporters are likely to experience income loss (from preference erosion) despite possible increases in sugar exports to the EU. World sugar prices are expected to shift upward due to the EU sugar reform, but an even greater influence on prices may be rising demand for and production of sugar-based ethanol, mostly from Brazil. A tighter world sugar market and rising prices would benefit developing-country sugar exporters, partly offsetting export losses from the EU reform.

Finally, the EU sugar reform could have implications for the WTO. The reform not only reduces EU export subsidies to a level within current WTO limits, but it also might facilitate a phased removal of export subsidies by the EU as is called for in the Doha Development Round. In the area of domestic support, cuts in the intervention price and lower production would reduce the EU's aggregate measure of support. However, in the area of market access, the EU reform does not address the high import tariff barriers for sugar exporters outside preferential agreements. Reducing these import barriers could potentially have far greater impact on world sugar markets, including nonpreferential sugar trade.

How Was the Study Conducted?

This analysis of the EU sugar reform features qualitative and quantitative components. The qualitative assessment offers insights into the likely shifts in production, prices, and trade resulting from the reform, given key characteristics of the sugar industry. Due to the complexity of the EU sugar regime and the various interconnected issues to disentangle, the quantitative assessment of the reform required use of both partial and general equilibrium models. The partial equilibrium-based analysis incorporates details of the EU domestic sugar sector and policies, and the general equilibrium model directly addresses bilateral trade, distinguishing between preferential and nonpreferential trade flows and offering an account of both import and export policies. A unique contribution of this report is its explicit modeling of imperfect competition and the oligopolistic behavior of the EU sugar industry and how these attributes affect the expected responses to the policy reform.