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Sugar Situation in the European Union

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The EU sugar industry under pressure

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The EU sugar industry before reform

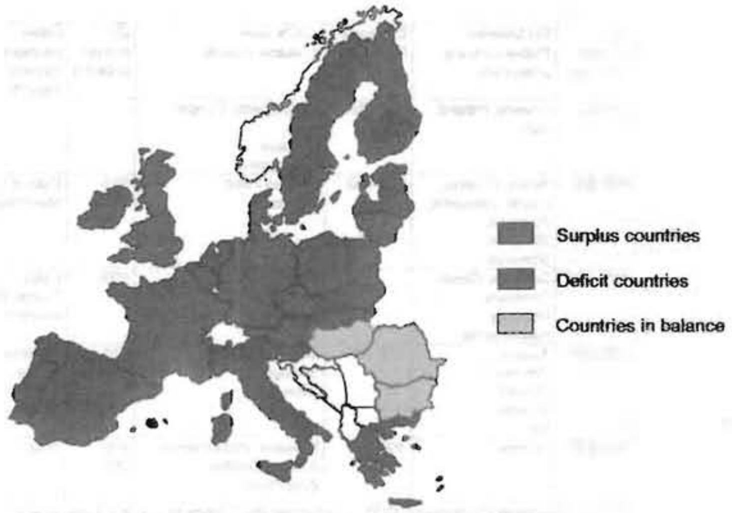
EU sugar industry before reform

- Before the reform in 2006, sugar was produced throughout the EU with only 4 countries being non-producers - Cyprus, Estonia, Luxembourg and Malta

- EU "25" sugar industry features in 2004/05:
  - 20 mt beet white sugar production from 2.14 m ha
  - 303,000 growers with an average beet area of 7 ha each and average yield of 9.14 tonnes white sugar/ha
  - 188 beet sugar factories with 53 k employees
  - 7 cane raw sugar refineries for 1.8 mt wse imports
  - <u>The world's second largest net exporter</u> after allowing for preferential imports

Source: CEFS (2006), <u>Sugar Statistics 2006</u>, Brussels and ISO (2006), <u>Sugar Year Book 2005</u>, London

Chart 1: The best EU areas for beet sugar production



Note: Surpluses and deficits take account of beet sugar production and raw cane sugar import allowances.

Chart 2: Varying EU cost positions

European Commission (2005), Updated Impact Assessment, SEC(2005)808, p.12

Figure 1 Relative Position of Member State Sugar Beet Farmers and Factories according to Costs

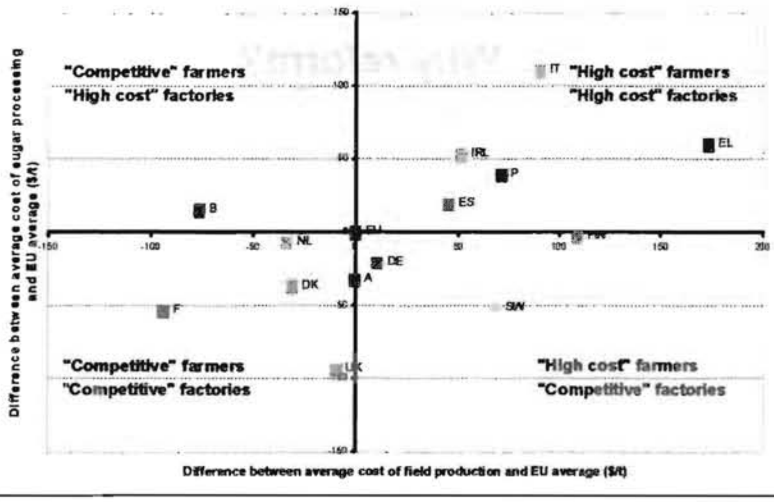


Table 1: Varying ACP/LDC cost positions with EU comparison

EU market Price €/t	EU Member States ceasing production	EU market Price €/t	LDC's likely to cease exports	EU market price €/t	Other partners ceasing exports
725-625	Greece, Ireland, Italy	725-650	Bangladesh, Congo (DR), Jamaica, Madagascar		
625-525	Spain, Finland, Latvia, Lithuania, Portugal, Slovakia, Slovenia	650-550	Burkina Faso Tanzania	650-550	Cote d'Ivoire Mauritius
525-475	Belgium, Czech Denmark Hungary Netherlands			550-475	Cuba Congo (Braz) Guyana
475-425	Austria Germany Poland Sweden UK	475-400	Malawi Senegal Swaziland	475-400	Balkans Belize India Fiji
425-400	France	400-250	Ethiopia, Mozambique, Sudan, Zambia Zimbabwe	400-250	Brazil

Source: European Commission (2003), Reforming the European Union's sugar policy: Summary of impact assessment, SEC(2003)1022, p.27.

Why reform?

Key reasons for reform

A. External reasons

1. The introduction of open-ended access for imports from the least developed countries (the LDC's) from 2009
2. The reduction of exports due to the loss of the WTO Sugar Panel in 2005

B. Internal reasons

3. The logic of CAP reform where the EU is moving away from its traditional market support methods to more WTO-conformable and environmentally sustainable measures

External reasons for change: EBA

- In 2001 the EU introduced its Everything but Arms (EBA) initiative. This allows all imports from the least developed countries duty and quota free access to the EU market
- For sugar, EBA's full application is delayed until 2009
- As a response to the EBA initiative the EU has:
  - cut production to allow for increased imports of EBA sugar
  - But, in order to avoid its market being overwhelmed by EBA imports, the EU has cut support prices to make its market less attractive
- As part of the Doha Round, other developed and advanced developing countries are meant to apply similar schemes, although the US wants to exclude 3% of tariff lines (to cover items such as sugar)

External reasons: the WTO

The WTO Sugar Panel

- The 2005 WTO Sugar Panel loss means the EU has to eliminate out-of-quota exports and ACP re-exports as these were found to be subsidised. The result is that the EU can only export upto its WTO subsidised export limit of 1.374 mt wse.

- Exports used to run at some 5-6 mt a year. In future they cannot exceed the 1.374 mt limit.

- Again the EU needs to cut its production, but this time to take account of the quantities it can no longer export

The Doha Round

- Sugar regime reform has been geared to applying sufficient support price cuts for a Doha Round deal to be implemented without further reform

- Including sugar beet in the Single Farm Payment scheme means virtually all sugar support will be in the WTO Green Box.

Internal reasons for Sugar Regime change: CAP Reform

- The logic of CAP reform is that CAP support should be given in a WTO-conformable manner, so:

  - Farmers should produce for markets, not farm for support measures

  - Market price support levels and measures are being reduced for all CAP products

  - Most CAP support is to be paid as a Single Farm Payment **decoupled** from production (so in the WTO Green Box) and only if environmental conditions are satisfied

  - All CAP products to be treated the same

  - **Sugar can no longer be unique**

Chart 3: Evolution of EU support prices 1992-2007 ***(as % of 1991 support prices)***

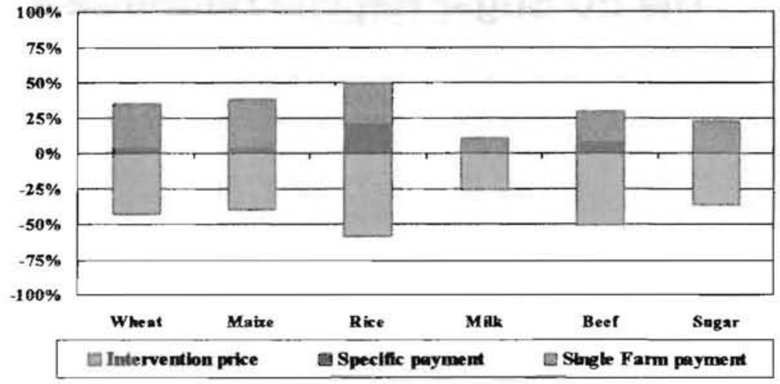
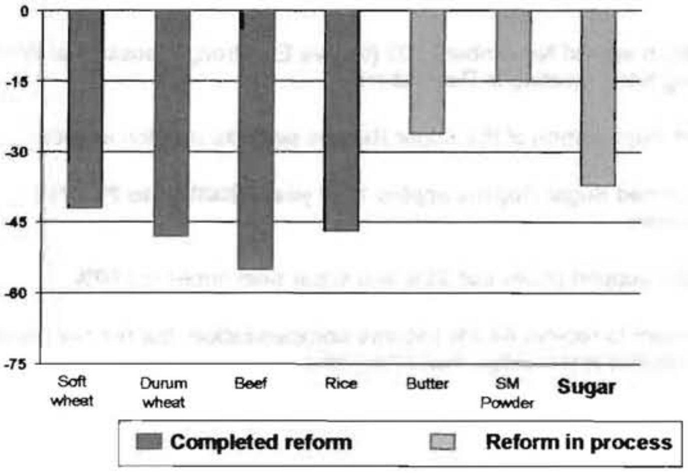


Chart 4: EU support price reductions

(Cumulative % reduction in price support)



The EU Sugar Regime reform as agreed

Sugar Regime reform decisions I:
Support price cuts

- Reform agreed November 2005 (to give EU stronger position at WTO Hong Kong meeting in December)
- First major reform of the Sugar Regime since its creation in 1968
- Reformed Sugar Regime applies for **9 years 2006/07 to 2014/15** inclusive
- Sugar support prices **cut 36%** and sugar beet prices cut **40%**
- Farmers to receive **64.2% income compensation**, but not directly as it is included in the Single Farm Payment

EU support prices post-reform

(expressed in €/metric tonne and US $/short ton)

- The new support levels are being phased-in and will apply in full from 1 October 2010
- Taking the 21 July 2006 rate of 1€ = US$1.2687:
  - White sugar: €404.0/mt = $465.0/st or 23.2 c/lb
  - Raw sugar: €335.0/mt = $385.6/st or 19.3 c/lb
  - Sugar beet @ 16% sugar: €26.3/mt = $30.3/st
- Caution: in recent years, average fx rates have varied from 1€ = US$0.89 (2001) to 1€ = US$1.27 (2006)
- So the EU white sugar price could be equivalent to anywhere between $326/st to $465/st, depending on the exchange rate applied

Sugar Regime reform decisions II:

Production slashed

- The EU has been forced to **cut sugar production** to take account of drastically reduced exports (WTO Sugar Panel) and increased imports (EBA)
- The Commission <u>target</u> is to cut <u>total</u> EU sugar production 40% to 12½ mt and <u>quota</u> production 30%
- The result will be that the EU will go from being a net exporter **to being a net importer** like the USA
- The EU cedes its world market share to Brazil
- EU sugar production is cut back to allow for LDC imports

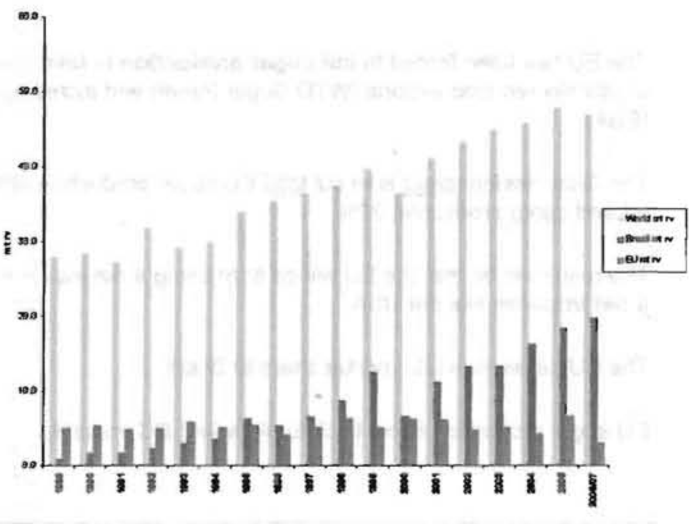
Table 2: EU "25" sugar balance change as a result of reform

	2005/06	2012/13
EU Production [Quotas]	20.3 [17.4]	12.4 [12.4]
Imports	1.9	3.9
Total Supplies	**22.2**	**16.3**
EU Consumption	(16.3)	(15.7)
Exports	(5.9)	(0.6)
Net Exports / (Imports)	**4.0**	**(3.3)**

Source: European Council Working Party on Sugar, September 2005

Chart 5: World market shares

(in million tonnes raw value)



Sugar Regime reform decisions III:
Restructuring Fund

- Application of a standard industrial measure (a restructuring scheme) for the first time in agriculture
- **Voluntary** quota renunciation over **4 years**: 2006/07 to 2009/10 inclusive
- Funding: some **€6 billion** (say US $7.6 billion) raised through consumer levy
- Aid rates: degressive to encourage early uptake
  - €730/t ($926) in 2006/07 and 2007/08
  - €625/t ($793) in 2008/09
  - €520/t ($660) in 2009/10
- Full funding rates only where factories demolished

Why is the reform process not going smoothly?

Reform came at too high a price

- To buy Member States' agreement to reform there was a 'Christmas Tree' of extra measures added as sweeteners
- Quota renunciation is blocked by two of these measures in particular:
  - That growers should have 'at least' 10% of the Restructuring Aid, rather than a fixed amount
  - That governments can take away 25% of quotas for reallocation to other companies
- The result is that:
  - Governments have to set the grower percentage in acrimonious talks at higher levels than intended (e.g. in Ireland, it is set at 32%).
  - This, plus the 25% quota provision, has given effective tools to those Governments wishing to dissuade companies from renouncing quota
- The consequence is a 2 mt quota renunciation shortfall in 2007/08

Table 3: Restructuring Scheme shortfall

Million tonnes wse	Planned quota buy-out	Actual	Shortfall
06/07	1.5	1.5	-
07/08	2.7	0.7	2.0
To come			
08/09 & 09/10	1.8	best 1.2?	best 0.6?
Total	6.0	3.4	2.6

Market overhang

- There is a large surplus as:
  - ➢ The reform started with too high a level of stocks
  - ➢ The level of quota renunciation is inadequate
- Mrs Fischer Boel has warned the Council that there could be a 4 mt surplus for 2007/08
- An advance quota withdrawal of 2 mt has now been agreed so that farmers can cut sowings for 2007/08
- The industry has suggested improvements to the Restructuring Fund to make it more effective, including giving farmers a fixed share and keeping the level of Restructuring Aid unchanged for 2008/09

Results of reform

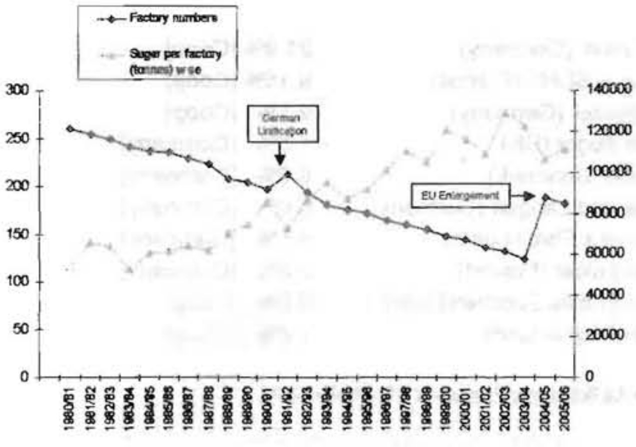
Results of Reform

- The EU sugar industry downsizes
- Industry ownership becomes more concentrated
- The industry restructures and diversifies to become more competitive
- The industry develops into bioethanol

Reform outcome so far

- Since the reform was agreed:
  - 48 plant closures announced (26% of the total)
  - 3 countries have stopped production entirely (Ireland, Latvia and Slovenia)
  - 3 countries (Greece, Italy and Portugal) have halved, or more than halved, beet sugar production
  - 1.8 mt of sugar quota (10%) and 0.3 mt inulin quota (100%) have been renounced for 2006/07 and 2007/08, but partly offset by 0.87 mt of C sugar conversion to quota
  - In the first year of reform (2006/07), sowings were cut 450 k ha (to1.7 m ha) and production cut 3.75 mt (to 16.5 mt wse) as out-of-quota sugar production was largely eliminated

Chart 6: Factory rationalisation before reform (factory numbers and average size)



Measures being taken

- Longer processing campaigns for factories being kept
- Restructuring of grower base to raise productivity
- Company mergers and/or marketing alliances (e.g. Nordzucker and Cristal Union form EuroSugar; CSM merges with Cosan; SDHF merges with Tereos)
- Diversification into bioethanol (now) and off crop cane raw sugar refining (in 2009)
- Expansion overseas (e.g. Tereos in Brazil and Mozambique; British Sugar in China and Southern Africa; Finasucre in Australia and the Congo)

Leading processors at the start of reform

(% EU "25" quota)

Sudzucker (Germany)	21.8% [Coop]
Tereos + SDHF (France)	9.15% [Coop]
Nordzucker (Germany)	9.1% [Coop]
British Sugar (UK)	7.6% [Company]
Danisco (Denmark)	6.6% [Company]
Pfeifer und Langen (Germany)	5.0% [Company]
Azucarera Ebro (Spain)	4.5% [Company]
Polski Cukier (Poland)	3.8% [Company]
Copro B/Italia Zuccheri (Italy)	3.5% [Coop]
Cosun (Netherlands	3.4% [Coop]

Source: La Betteravier Français, 20 September 2005

EU switches from being a net exporter to being a net importer

- The EU will go from being the world's second largest sugar exporter to the world's second largest net importer
- In the past the EU exported 5 to 6 mt and imported 2 mt: **net export** 3 to 4 mt
- In the future the Commission expects the EU to be importing 3.9 mt with barely any exports: **net import** of some 3.5 mt

Bioethanol

Why the EU is concerned about its energy supplies!

EU biofuels: regulatory background

- Directive 2003/30: sets voluntary targets of 2% of transport fuels to be biofuels in 2005 and 5.75% in 2010
- Some MS are developing biofuels faster than others. France has introduced higher national incorporation targets 7% (2010) and 10% (2015), while the UK is lagging far behind
- In January 2007, the Commission proposed the EU should adopt a target of a 10% minimum biofuel market share in 2020: this target to be mandatory
- It also proposed the introduction of measures to reduce environmental risks from increased biofuel production
- The EU is to increase its research funding for second generation biofuels

Table 4: Some national targets for biofuels use

	Biofuel market share (%)		Biofuel target (%)	
	2003	2005	2005	2010
Austria	0.06	0.93	2.50	5.75
Belgium	0.00	0.00	2.00	5.75
France	0.67	0.97	2.00	7.00
Germany	1.21	3.75	2.00	5.75
Italy	0.50	0.51	1.00	5.00
Netherlands	0.03	0.02	2.00	5.75
Poland	0.49	0.48	0.50	5.75
Spain	0.35	0.44	2.00	?
Sweden	1.32	2.23	3.00	5.75
UK	0.026	0.18	0.19	3.50
EU "25" TOTAL	**0.5**	**1.0**	**1.4**	**5.45**

Source: European Commission 2006, Biofuels Progress report, SEC (2006) 1721/2

EU bioethanol

- Upto now, EU ethanol production has largely been for potable and other non-fuel uses (France has had ethanol from sugar beet since before WWII)
- **The current wave of bioethanol development for fuels is only just starting**
  - It is expected that this will largely be based on wheat (75%) with sugar beet providing the rest (25%)
- Initial impacts are likely to be limited as:
  - The EU has very significant exportable cereal quantities (25 mt in 2006)
  - It has 10% of arable land area in Set-Aside
  - The EU is able to supply non-quota sugar beet as needed

Table 5: EU "27" crop forecasts to 2013

	2004	2006	2013	Change	
Cereals (mt)					
Production	286.2	242.5	301.1	+14.9	(+5%)
Consumption	243.4	246.8	278.9	+35.5	(+15%)
Of which: bio-energy	0.5	1.9	18.6	+18.1	(+372%)
Exports	23.3	24.9	32.8	+9.5	(+41%)
Oilseeds (mt)					
Production	20.1	20.1	32.3	+12.2	(+61%)
Consumption	36.5	44.3	66.4	+29.9	(+82%)
Of which: bio-energy	4.6	7.9	18.8	+14.2	(+309%)
Imports	20.5	23.7	34.7	+14.2	(+69%)
Sugar (mt) [Figures include out-of-quota sugar for industrial use]					
Production	19.6	17.4	15.6	-4.0	(-20%)
Consumption	16.1	17.4	20.8	+4.7	(+29%)
Of which: bio-energy	0	1.0	2.2	+2.2	(...)

European Commission DG Agri (January 2007), Prospects for agricultural markets and income in the EU 2006-2013, pp 50/52