DOCUMENTATION

PREFERENCE EROSION IN MULTILATERAL NEGOTIATIONS – THE EXAMPLE OF THE EUROPEAN SUGAR SECTOR

DOCUMENTATION OF THE DISCUSSION FORUM IN HONG KONG ON 14 DECEMBER 2005

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Preference Erosion in multilateral negotiations – the example of the European sugar sector

Documentation of the discussion forum in Hong Kong on 14 December 2005

During the Sixth WTO Ministerial Conference in Hong Kong, Germanwatch and the German Development Institute (GDI, Bonn) invited representatives of the sugar industry, sugar growers, delegates of governments, ambassadors, scientists, representatives of NGOs from Brazil, Malawi, South Africa, Thailand, Zambia, Germany and France. They discussed the development effects of the recently agreed reform of the EU sugar market organisation, the different impacts on and interests of the developing countries as well as possible ways of compensating the losses of developing countries.

Preference Erosion

In multilateral trade debates, preference erosion[1] is a central concern for many developing countries which presently have a preferential access to the markets of industrialized countries. From an economic point of view, it is, however, not really unequivocal whether such preferential accesses really (always) contribute to progress in development: on the one hand, developing countries profit from considerable export income, but on the other hand, their dependence on industrialised countries increases. Industries that might otherwise not be competitive are being protected and – as many economists presume – intransparency as well as profit taking by some few increase.

Particularly in the agricultural sector preference erosions are such an important issue because this is the most protected sector of all. The EU sugar market is a prominent example for preference erosion: The EU sugar market organisation hitherto did not only protect the European sugar farmers by high duties and guaranteed high prices, but was also profitable for the African, Caribbean and Pacific states (ACP countries) which received the same high prices and could sell a guaranteed amount on the EU market. But since the European sugar market has already been more than saturated, these amounts had to be re-exported without exception. However, there are many developing countries that produce sugar (or have the potential for it), and they often have very different production structures and costs or conditions for market access; therefore it is not possible to generalise effects of the reform of the EU sugar market organisation. Such differences also became apparent in the discussion.

[1] Reduction of the value of a “preferential access to the market“. The reason for it can on the one hand be a reduction of duties. In this case, competition increases because the difference between the lower duties that are granted to many developing countries (=preferential access to the market) and the duties valid for all countries decreases. On the other hand, the value of a preferential access to the market also decreases when the internal agricultural prices in the EU decrease due to the agricultural reforms.

Ethyl alcohol obtained from sugarcane as a development perspective for Brazil

Brazil has a great potential for the cultivation of sugarcane. To a great extent, it is not only used to produce sugar, but also alcohol. Brazil is one of the biggest consumers and the biggest exporter of sugar worldwide. Due to the high non-preferential import restrictions, however, almost nothing is delivered to Europe. The production of alcohol from sugar is considered an important economic perspective not only for Brazil, but for many other developing countries as well. Eduardo Carvalho from the Brazilian Sugarcane Farmers' Association explains the advantages: *"Using alcohol as fuel supports climate protection, its production does not need to be subsidised, and the small-scale farmers profit from sugar cultivation".* According to Mr Carvalho, alcohol obtained from sugarcane is economically, ecologically and socially sustainable and significantly contributes to reducing poverty.

40 new factories are planned. In Brazil, it is stipulated by law that biological alcohol has to be added to the pure spirit; thus, any amount can be marketed. The question is whether Brazil will also supply the European market. This will particularly depend on how the EU is going to organise compulsory addition of biological alcohol, and on the amount of import duties for biological alcohol.

Swaziland does not only export sugar

Swaziland is one of 20 ACP countries benefiting from a quota for sugar imports into the EU within the framework of the Sugar Protocol.[2] For many of these countries sugar is the most important export product, and their economies highly depend on sugar exports. As a result of the reform of the EU sugar market organisation, Swaziland loses important income when the EU cuts their sugar prices by about 36 %. But Swaziland does not only export sugar: The country also exports beverages containing sugar which is confronted with other import barriers. In order to find solutions for competitive sugar production, it is necessary not only to consider the agricultural sector and its trade regulations, but also the trade regulations for industrial goods.

Sugar production in Malawi

In some of the 50 poorest countries in the world (Least Developed Countries, LDC), sugar is an important agricultural product, like for example in Malawi. Under the Everything But Arms (EBA) initiative, LDC benefit from duty- and quota-free access to the European Market. This is particularly relevant for sugar producers, since the EU sugar prices are artificially kept high by customs barriers and the sugar market organisation. For most other products the customs barriers have either already been low before EBA, or they are not produced in LDC at all.

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[2] The Sugar Protocol is an agreement between the EU and the ACP states. With it, the EU grants ACP states the permission to import sugar duty-free and at minimum prices into the EU. The WTO has decided that the Sugar Protocol violates WTO rules.

Malawi’s sugar industry is competitive, apart from an ACP quota within the framework of the Sugar Protocol it is also able to export into neighbouring countries. Since Malawi is a landlocked country, transport costs, however, are considerable, amounting to 30 per cent of the production costs. Many African sugar exporters do not have direct access to the sea; otherwise they would be absolutely competitive on the world market. Due to the EU sugar market reform Malawi loses both incomes from the already existing exports in the framework of the ACP quota as well as considerably higher potential future incomes resulting from the EBA initiative. On the other hand, Malawi will profit as an ordinary exporter when world market prices rise due to decreasing EU sugar exports.

Possible ways of compensation

Dr. Rudolf Buntzel from the Church Development Service (Evangelischer Entwicklungsdienst – EED) explains the NGOs’ positions: *"The losses which ACP and LDC countries incur due to the reform of the EU sugar market organisation have to be compensated. The funds for this must not come from development funds, but from funds of the sugar regime."*

At present the EU sugar market organisation is basically organised in such a way that consumers have to pay a price for sugar that is twice or thrice as high as the world market price. This money is amongst other things used to subsidise the export of the EU producers’ surplus. On the other hand, the re-export of preferential sugar from ACP and LDC imports is financed from the EU budget.

Since the situation of the sugar sectors is different in each country, it should be allowed to use compensations flexibly. National action plans are a useful instrument to this end. According to Dr. Rudolf Buntzel, the national action plans of the EU in principle are an appropriate answer to the diverse requirements in the individual countries. According to him, the ones who profit from the national action plans are the countries, not the sugar manufacturers and not even the sugar farmers.

Malawi supports the idea of national action plans. Bupe Mulagu and Borzian Mtonya, members of the government delegation of Malawi, strongly criticise that the planned compensations for the loss of preferences will be paid from the development fund. *"The compensations thus compete with money that could otherwise be used for example in order to avoid HIV and AIDS."*

Malawi demands money for its losses due to the new EU sugar market organisation as an adaptation support to improve their competitiveness. However, there are different opinions regarding the question of how to designate this support for adaptation measures.

In the opinion of stakeholders in Malawi, "compensation" sounds too much like charity. Their long-term goal is an independent sugar industry that does not need help from outside. In the case of Malawi, investments in the sugar sector and in trade-related infrastructure are the correct answer.

Michael Brüntrup from GDI explains that the EU considers the term "compensation" problematic for other reasons. They fear that it might be interpreted as a legal obligation – parallel to the European sugar manufacturers’ rights based on the long-term support received. "However, just because the term 'compensation' implies a legal obligation it might be useful for LDC and ACP countries", says Michael Brüntrup.

Another debate has arisen around the issue of whether such a support for adaptation measures would be a bilateral business between the EU and the countries that lose their preference, or rather a multilateral issue. In the first case, the EU would be the only one responsible for compensation, with all the disadvantages there are (lack of obligation, unclear allocation). On the other hand, the support can also be regarded - as the WTO does - as part of the whole negotiation process, which admittedly has winners and losers. In this case compensation payments for preference erosion could be established in a multilaterally binding way and would no longer depend on the political decision-making processes of individual countries or - in the case of the sugar market organisation - of the EU, respectively. Consequently, all countries profiting from liberalisation, i.e. including countries like Brazil, would have to pay.

This is an absurd idea for Eduardo Carvalho, representative of Brazilian sugarcane growers: *"Brazil has suffered from the export subsidies for decades, and now we shall pay for its abolition?" he asks.*

With its new Trade Integration Mechanism, the International Monetary Fund has in principle already created an element of compensation, although on a credit basis. A financial compensation (without credit) is an additional instrument that can be justified both on a moral basis and for political reasons - in order not to let the WTO negotiations fail because of the losers, or rather in order to get them in the right mood for liberalisation. Michael Brüntrup explains: *"On the basis of the WTO’s mercantilistic logic a multilateral compensation mechanism would be the correct answer."*

The participants’ conclusion: in any case the support has to be adapted to each country – in the case of Malawi this means support for the expansion of the sugar industry and for diversification. In other cases, where sugar is not competitive, solely support for production diversification.

List of participants

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Mtonya, Brian	Malawi Delegate
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Pena Lopes, Yvette	International Brotherhood of Teamsters
Pichpongsa, Wanlop	Thai Chamber Of Commerce
Tamen, Emmanuel N.	ITIA
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Germanwatch

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