The European sugar market and the impact of Brexit

Developments in sugar exports of African, Caribbean and Pacific countries

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On behalf of BMZ, the policy brief series of the sector project „Agricultural Trade, Agribusiness, Agricultural Finance"summarizes the results of working papers that are relevant to specialist audiences.

SUMMARY

The European sugar market has been subject to reforms throughout the last decade, such that the previously very high sugar prices in the European Union (EU) increasingly align with world market price from 2009 onwards. For African, Caribbean and Pacific (ACP) countries[1] exporting sugar to the EU these reforms reduce the volume and value of their sugar exports, threatening an important source of income: in Belize, Guyana, Mauritius and Malawi, sugar accounts for between 3% and 5% of Gross Domestic Product (GDP), and as much as 13% in Swaziland. In addition, in several of these countries the sugar industry provides social services such as education and health services.

The United Kingdom (UK), the main European importer of sugar from ACP countries, decided to leave the EU in March 2019. How will Brexit affect the ACP countries, given the already ongoing changes in the EU sugar market?

An analysis of these impacts requires an assessment of future trade relations between the UK and the EU and between the UK and third countries. Five scenarios have been developed to estimate possible consequences of the UK's withdrawal from the EU for ACP sugar exports. Depending on the scenario, the UK's exit from the EU may have negative consequences for sugar-exporting ACP countries, lead to no significant change or may even have positive effects, at least in the short term. It is clear that the impact of Brexit on ACP countries depends heavily on Britain's future policy. Nevertheless, there are measures that can be taken by the EU to improve the situation of the sugar-exporting ACP countries:

- Adopt flexible rules of origin in an EU-UK trade agreement to allow ACP sugar and products containing ACP sugar to continue to be traded easily between the EU and the UK.
- Support ACP countries in adapting to the changes in the European / British sugar market.
- Support in meeting social and environmental standards despite increased competitive pressure.

1 The ACP states are 79 African, Caribbean and Pacific countries, of which many are former colonies of EU member states, and that therefore have a special relationship with the EU.
Sugar-exporting ACP countries: Barbados, Belize, Benin, Burkina Faso, Côte d'Ivoire, Cuba, Democratic Republic of Congo, Dominican Republic, Ethiopia, Fiji, Guyana, Jamaica, Kenya, Madagascar, Malawi, Mauritius, Mozambique, Senegal, Sierra Leone, South Africa, Sudan, Swaziland, Tanzania, Togo, Trinidad & Tobago, Uganda, Zambia, Zimbabwe.

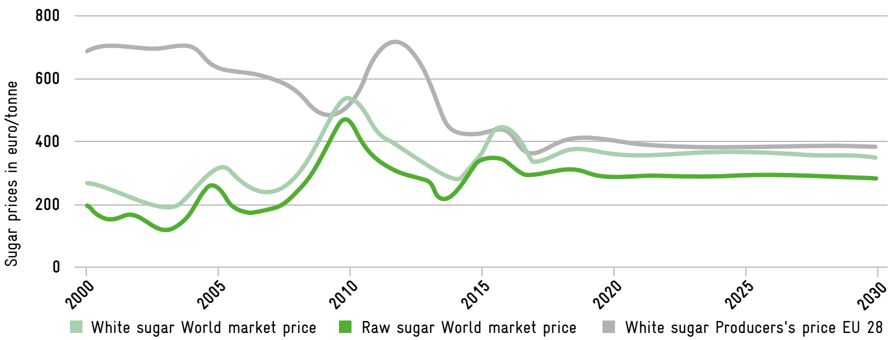
BACKGROUND

The European sugar market and ACP countries

The EU is a major player in the global sugar market: it is the world's third largest producer of sugar as well as the third largest importer. Traditionally, sugar cane exports to the EU have been an important source of income for some ACP countries. Due to production quotas, market support and high tariff protection against imports, the sugar price in the European market used to be far above the world market price. ACP countries were able to import their sugar duty-free into the EU on the basis of a preferential agreement – the Sugar Protocol – and thus benefited from high European prices.

However, this situation began changing with the gradual reform of the European sugar market, which began in 2006. Among other things, the minimum sugar price in the EU was lowered, simultaneously production quotas were reduced and then completely abolished in October 2017. As a result of the reforms, the sugar price in the EU has become more aligned with the world market price, i.e. it is lower but also more volatile (see chart below). As a consequence, revenues of both European and ACP producers have declined. In addition, the abolition of production quotas in 2017 led to an expansion of the European sugar production. According to the projections of a comprehensive report on the topic, the EU will import significantly less in the future due to the reforms and it will therefore switch from a net importer of sugar to a net exporter.

Comparison of sugar prices in the EU and on the world market



Source: European Comission (2017), European Agricultural Outlook (p. 22)

Sugar: Production from sugar cane and sugar beet

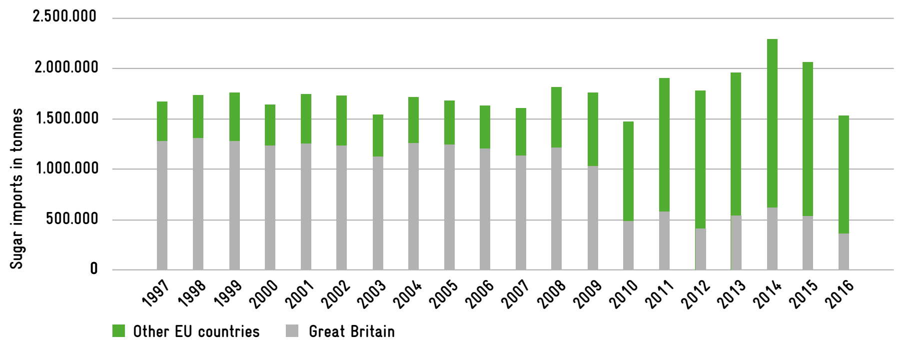
Sugar can be produced from both sugar beet and sugar cane. The cane and the beet are transformed into raw sugar, which can be further refined into table sugar („white sugar"). Around 80% of sugar worldwide is made from sugar cane and 20% from sugar beet; in the European Union the ratio is the reverse. A smaller portion of the sugar goes directly into final consumption and retail; the majority is used in the food industry in processed goods.

Given the importance of the European market for ACP countries, the expected halving of the EU's sugar import volume as well as lower sugar prices pose a significant challenge to sugar-exporting ACP countries. These forecasted developments will in particular affect countries like Barbados, Fiji, Guyana, Jamaica, Mauritius and Swaziland that export a large proportion of their sugar to the EU and have no alternative markets available. Countries like Malawi that might be able to redirect a part of their exports to regional markets would be less affected.

The role of the United Kingdom

Historically, the UK has played a special role in the ACP sugar trade. Until 2009, the preferential access of the ACP countries to the European market was based on the EU Sugar Protocol. This agreement between the EU (at that time European Economic Community – EEC) and ACP states was a result of the British accession to the EEC in 1973, to maintain the historic preferential trade relations between the United Kingdom and its former colonies, in particular the Caribbean.

EU sugar imports from ACP states, without South Africa and Cuba



Source: Own presentation with data from EUROSTAT

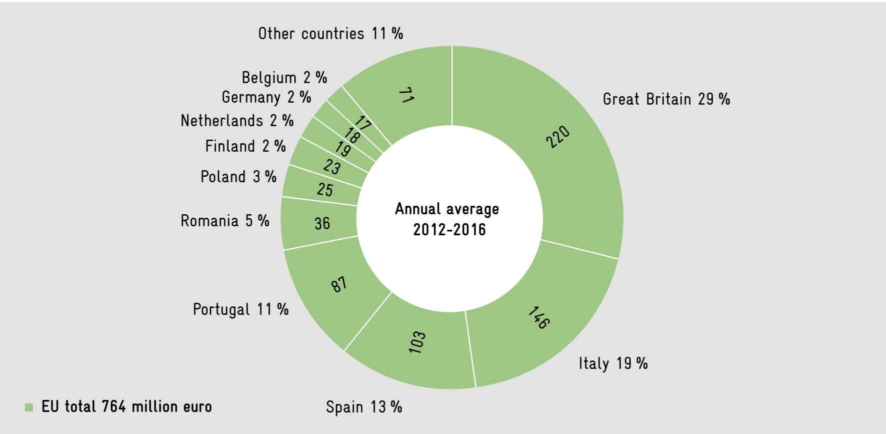
→ https://ec.europa.eu/agriculture/sites/agriculture/files/markets-and-prices/medium-term-outlook/2017/2017-fullrep_en.pdf
2 Study on Current and Forecast Market Developments for ACP Sugar Suppliers to the EU Market:
→ http://www.acp.int/sites/acpsec.waw.be/files/Sugar%20Report.pdf

3 All WTO member states generally grant each other the same market access. However, through bilateral and regional trade agreements, countries can grant the other parties in the agreement better („preferential")

In 2009, the Sugar Protocol was abolished. Since then, least developed countries (LDCs) have duty-free and quota-free access to the European market via the Everything But Arms (EBA) preferential agreement, and most non-LDC ACP countries have duty-free and quota-free access to the EU market through the Economic Partnership Agreements (EPAs) with the EU. A few other countries have sugar import quotas into the European Union through bilateral trade agreements with the EU. All remaining EU sugar imports are subject to very high tariffs of up to 419 Euro per ton of sugar.

For several decades, Britain's share of ACP sugar imported into the EU was well above 70%. This changed with the European sugar market reforms. In addition, the EU's capacity to process cane sugar, which was previously concentrated in the United Kingdom, has extended to other Member States. Today, the UK is responsible for slightly less than 30% of all EU sugar imports from ACP countries. Despite this decline, the UK is still the largest EU importer of sugar, ahead of Italy and Spain.

Annual ACP sugar exports to EU member states 2012-2016 (in million Euro)



Source: Own representation with data from ITC Trade Map

The UK's importance as the EU's largest importer of sugar from ACP countries makes it relevant to understand the consequences that Brexit will have for sugar-exporting ACP countries, in particular against the background of the general deteriorating situation due to the ongoing EU sugar market reforms.

ANALYSIS

In order to analyse the consequences of the UK leaving the EU, it is necessary to model possible future trade relations of the UK with the EU and with third countries, as their specific design is currently still unclear. In the following pages, five different scenarios assess the potential impact of the UK leaving the EU.

The scenarios are based on the assumption that the UK will transitionally adopt the EU Economic Partnership Agreements (EPAs) and thus continue to provide duty-free and quota-free access to the British sugar market for most ACP countries. Also, based on announcements made by the British Government, it is assumed that the United Kingdom will continue to grant least developed countries (LDCs) duty-free and quota-free market access through the EBA agreement and will take over a share of EU sugar quotas within the WTO.

If the UK decided against continuing the application of EU preferences, ACP countries would lose preferential access to the UK market and would have to pay the same high tariff as all other countries without preferential access. In this case their exports to the UK would be expected to drop sharply. However, based on the announcements made by the UK Government, it can be assumed that the preferences will continue to apply.

Scenario 1 | Customs Union

After leaving the EU, the UK remains in a customs union with the EU that includes the agricultural sector. In this case very little would change compared to the current situation. Trade between the EU and the UK would not face additional border checks, the UK's external tariffs would be aligned with the ones of the EU, and the UK would use the same rules of origin towards third countries as the EU. Sugar could be traded between the EU and the UK as it is currently done. Due to the reforms in the European sugar market, the volume and revenues of sugar exports from ACP countries would decline in the long term, as discussed above. In particular, ACP countries with high production costs and no access to other markets would be adversely affected.

Scenario 2 | Free Trade Agreement Version 1

The EU and the UK agree on a bilateral trade agreement to ensure that trade in all products, including sugar and sugar-containing products, remains duty-free. The United Kingdom continues to apply the EU's external tariff towards third countries. Unlike in the Customs Union scenario, in this case it is necessary to examine the origin of products at the EU-UK border.

The impact of this scenario resembles that of the Customs Union scenario. The British and European sugar markets would continue to be integrated, but border controls would take place to determine the origin of products, thereby increasing the costs to traders. In order to replicate the current situation as far as possible, the rules of origin in the EU-UK trade agreement as well as trade agreements with third countries would have to be designed in such a way that ACP sugar and products containing ACP sugar could continue to be traded as before. In the case of liberal rules of origin, this situation would be similar to the scenario described above, yet with additional costs to prove the origin of the products. Less flexible rules would have a negative effect on ACP sugar sales as, for example, food containing ACP sugar might not be considered British and therefore might not benefit from the preferential duty in the EU – UK trade agreement.

The importance of Rules of Origin (RoO)

Rules of Origin specify the country of origin of a product, thus ensuring that only eligible products can benefit from the preferential tariff rates agreed in a trade agreement. While the origin of unprocessed products such as wheat is easily identifiable, this is much more complicated for processed products. Moreover, some EU trade agreements apply different rules of origin for sugar. In any case, the refining of raw sugar into white sugar does not constitute sufficient processing to change the origin of the product: raw sugar from ACP countries, which is processed into white sugar in the United Kingdom, is still considered ACP sugar.

Scenario 3 | Free Trade Agreement Version 2

In this scenario, the EU and the UK agree on a bilateral trade agreement to ensure that EU-UK trade in all products, including sugar, remains duty-free. The UK also liberalises the external tariff vis-à-vis third countries. In this case, Britain would still be able to import duty-free sugar from the EU as well as cane sugar from the most competitive third countries, leading to a lower sugar price in the UK. If the external tariff was completely liberalised vis-à-vis third countries, a large proportion of imports from ACP countries would likely be displaced by imports from more competitive countries such as Brazil.

From a development perspective, also in this scenario it is relevant to agree on flexible rules of origin for ACP products. For example, processed food produced in the EU and the UK containing ACP sugar should continue to qualify easily for the zero tariff rate set out in the EU-UK trade agreement. This could potentially even prove to be a competitive advantage for sugar-exporting ACP countries in comparison with countries such as Brazil, as the low tariff rate would not apply to sugar products from other countries.

Overall, this scenario is expected to result in lower revenues for ACP countries in comparison to today, but flexible rules of origin could help to partially mitigate this.

Scenario 4 | High external tariffs

In this scenario, the UK and the EU do not conclude a trade agreement. The UK would face the EU's external tariffs, and would equally apply high tariffs towards third countries, including the EU. This scenario is expected to result in the EU no longer exporting sugar to the UK, as British tariffs would be prohibitively high; equally, the UK would no longer export any sugar to the EU. However, as the UK's sugar trade balance with the EU is negative, the stop of EU sugar imports would lead to a decrease in supply on the British market and therefore to rising sugar prices. This would benefit ACP sugar exporters, as they would continue enjoying duty-free and quota-free access to the UK market through the EBA agreement and the continued EPAs.

For the EU, this scenario would lead to an increase in the supply of sugar as its exports to the UK exceed its imports from the UK by around 200,000 to 300,000 tonnes annually. This could lead to price pressure on the European market and lower imports, including from ACP countries. However, with EU market prices more likely to resemble the world market price in the future, this potential loss would probably be less than the gains ACP exporters could experience from higher UK prices and higher exports to the UK. In this scenario, the British market situation resembles the former European sugar market. Thanks to their duty-free and quota-free access to the UK market, ACP countries would benefit from the protected UK sugar market and the resulting high British sugar prices.

Scenario 5 | Full liberalisation

The UK and the EU do not conclude a trade agreement; the UK unilaterally cuts the tariff for sugar and sugar-containing products to 0% for all countries.

The abolition of the sugar tariff in the UK would benefit competitive sugar producers whose exports to the UK will likely increase. This, in turn, would reduce imports from less competitive ACP countries. Countries such as Fiji and Guyana, which export mainly to the UK market, could be strongly affected.

While processed EU food could continue to be traded duty-free on the UK market, British products exported to the EU would be subject to customs duties. In 2016, the United Kingdom exports of sugar confectionery, chocolate, processed cereal products such as cornflakes, bread, cakes and jams to the EU accounted for more than € 2 billion. As the EU has high tariffs for third countries on many of these products, it could be expected that these UK exports would fall sharply, thus negatively affecting the revenues of ACP producers that previously supplied the sugar for these products.

Overview of scenarios

Scenarios	Tariff between EU-UK	Customs tariff UK – 3rd countries (with which no free trade agreements exists)	Rules of Origin (RoO) necessary/ possible	Possible sugar price (UK) compared to the EU	Impact on sugar-exporting ACP states in comparison to no-Brexit
1 Customs Union	0 %	High external tariff (EU level)	No	Equal	No change
2 Free Trade Agreement Version 1	0 %	High external tariff (EU level)	Yes	Equal	No change
3 Free Trade Agreement Version 2	0 %	0%	Yes	Lower	Rather negative, depends on e.g. RoO
4 High External Tariffs	High external tariff (EU level)	High external tariff (EU level)	No	Higher	Rather positive
5 Liberal-isation	UK tariffs for all countries at 0%; UK faces external EU tariff	UK tariffs for all countries at 0%	No	Lower	Negative

Source: Own representation

CONCLUSION

The reforms of the EU sugar market that have been taking place since 2006 have resulted in a decrease in the volume and value of ACP sugar exports to the EU. Depending on the design of the United Kingdom‘s future trade policy, Britain‘s exit from the EU may cause this situation to become even more difficult for sugar-exporting ACP countries (Scenarios 3 and 5), remain broadly the same (Scenarios 1 and 2) or possibly - at least for a certain amount of time – improve again (Scenario 4).

The developments depend crucially on British policy and can only be marginally influenced by the EU. On the European side the following measures can however be taken to improve the situation of the sugar-exporting ACP countries:

- If an EU-UK trade agreement is concluded, it is important to push for the most flexible rules of origin possible. Sugar-exporting ACP countries need the greatest possible flexibility to allow their products to move freely between the EU and the UK. It is also important to support ACP countries early on in developing their positions regarding such a trade agreement and in influencing the EU and the UK Government accordingly.
- It does not seem absolutely necessary to insist that a trade agreement between the UK and the EU ought to include sugar. If Britain were to protect its markets, as described in Scenario 4, this could, at least in the short term, provide benefits for sugar-exporting ACP countries.
- In recent years, the EU has funded a programme to help ACP countries adapt to changes in the European sugar market. Further adaptation measures by ACP states should be promoted in order to make sugar production more competitive where appropriate, but also to diversify agricultural production so that countries becomes less dependent on sugar exports.

On behalf of

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