

**Forthcoming Changes in the EU Banana and Sugar Markets: A Menu of Options for an Effective  
EU Transitional Package  
Policy Brief**

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**The picture in brief**

Preferential access under the EU's Sugar and Banana Protocols has afforded large income transfers to a number of ACP countries. These transfers will be reduced under proposed reforms to the EU's sugar and banana markets which have had to respond to a number of internal and external pressures. Reducing preferences for sugar and banana exports from ACP Protocol countries will have beneficial effects on development and poverty reduction in other major producing countries which are not party to these agreements. However, losses for some Caribbean ACP suppliers will be high as higher production costs mean that these countries and regions can only sell profitably to a protected market. The most significant losses relative to external income will be for St. Vincent (bananas), Guyana (sugar), Dominica (bananas) and Belize (bananas and sugar). In the absence of assistance, countries losing from changes to the regimes may attempt to delay reform to the detriment of those countries which stand to gain.

The European Commission has indicated that it will be proposing specific measures to assist the ACP Protocol countries in adjusting to changes to the EU's Sugar Regime due to begin in 2006. This can be justified under the EU's international obligations because it is partially withdrawing from a binding undertaking which was of unlimited duration. In its sugar reform 'action plan', the European Commission proposes transitional assistance measures along three main axes: i) enhancing the competitiveness of the sugar sector, where this is sustainable; ii) promoting the diversification of sugar-dependent areas; and, iii) addressing broader adjustment needs. The emphasis will be on ACP countries themselves to design and implement country-specific strategies while the role of the Commission will be to propose a broad range of assistance options and deliver efficient support.

Our study identifies a number of options for an effective EU transitional assistance package to support sugar- and banana- dependent ACP countries. As part of this, we propose the creation of a dedicated preference erosion scheme to finance investments supporting industry restructuring and export diversification. The scheme would need to be predictable in order to encourage investment and to avoid strict conditionality to quicken disbursements.

**The importance of banana and sugar trade to developing countries**

*Bananas*

Most banana production (98 percent) is in developing countries. The majority of production is for domestic consumption, although for countries such as Ecuador, Colombia, Costa Rica and the Windward Islands, bananas are primarily an export crop. The five largest exporters are Ecuador, the Philippines, Costa Rica, Colombia and Guatemala. ACP countries account for only 6.3% of world banana exports, but the share of bananas in total merchandise exports from Caribbean ACP countries is especially high, for example, 42% for St. Lucia; 24% for Dominica; 18% for St. Vincent and Grenadines; and 10% for Belize. The two major importing regions and countries are the EU-25 and the US (together consuming 13% of bananas produced globally). Nearly all US imports of bananas originate from Latin America while EU imports originate from Latin America (80 percent) and ACP sources (19 percent including the Dominican Republic). Banana exports from ACP countries go almost exclusively to the EU.

For supplier countries and territories, for the most part highly dependent on income from banana exports, the import policies of the EU are of crucial importance. Higher production costs faced by European and Caribbean ACP producers mean that these countries and regions can only sell to a protected market. The resulting internal price on the European market, substantially higher than the world price, has enabled these producers to survive.

### *Sugar*

Over 80 percent of world sugar production and 60 percent of world trade relies on domestic support, export subsidies, and access to preferential markets. Only Australia, Brazil and Cuba have sugar sectors which operate at world market prices. World sugar production is 133.5 million tonnes of which the largest producers - the EU, Brazil and India - account for 43 percent. The ACP Sugar Protocol countries produce 4.2 million tonnes.

Global sugar tariffs are high (27.3%) and most sugar production (81%) is consumed locally in some of the largest producing countries (e.g. India and China). Brazil is the largest exporter of sugar accounting for about one quarter of world exports (38.5 million tonnes) followed by the EU and Australia. Most sugar produced in ACP Protocol beneficiaries is for export and is an important source of foreign exchange earnings representing 21% of merchandise exports for Guyana, 19% for Fiji and Mauritius and 15% for Belize. The largest sugar importer is the EU-25, accounting for 14 percent of world imports. Virtually all EU sugar imports originate from the ACP countries, the Western Balkans and India. About three quarters of sugar exports from the ACP countries go to the EU.

### **The EU's Banana and Sugar Regimes**

The banana and sugar industries in the Caribbean are, and always have been, a construct of policy. For bananas, the UK market was supplied exclusively from the Canary Islands until the British government decided to assist in the development of exports from Jamaica (in 1901) and the Windward Islands (after the Second World War). For sugar, the English began to cultivate cane in Barbados during the seventeenth century. The Napoleonic wars and the abolition of slave-based sugar production in the nineteenth century resulted in the development of a beet sugar industry in Europe, which resulted in tropical producers losing their natural absolute advantage to temperate zone competitors (and their subsidies) at least until bilateral agreements (e.g. the Commonwealth Sugar Agreement) divided up the market. Colonial preferences designed to continue transferring resources to traditional suppliers but also benefiting rent-seeking intermediaries have evolved into EU policy as EU membership has increased.

#### *The common organisation of the market in bananas*

Since 1993 the EU Banana Regime, or the common organisation of the market in bananas, has been one of specific tariffs (fixed charge per unit of imports) and tariff preferences (for ACP suppliers), and more importantly quotas. Banana imports in excess of these quotas incur a prohibitive tariff. This regime has frequently been challenged in the WTO by Latin American banana-exporting countries and the US. On 27 October 2004, the EU proposed a single duty on third-country imports of bananas of €230/tonne that will replace the current quota system from 2006. This will have serious consequences for ACP banana exporters.

#### *The common organisation of the market in sugar*

Sugar beet is grown in all EU Member States except Luxembourg, Estonia, Cyprus and Malta. The common organisation of the market in sugar, or the Sugar Regime, was first introduced in 1968. The Sugar Regime provides for guaranteed prices to producers and growers within the EU and controls the supply of sugar through quotas on production and imports, export refunds and intervention buying if the domestic price of sugar falls below an intervention price. The Sugar Regime is financed primarily by EU consumers (who pay higher than world prices) and levies on EU sugar production.

The Sugar Protocol provides a binding commitment, of indefinite duration, for 1,294,700 tonnes of preferential imports of cane sugar to the EU market at guaranteed prices from 19 ACP countries. There is also, an annual import allocation of between 200,000 and 350,000 tonnes of sugar to primarily ACP countries under the Special Preferential Sugar (SPS) arrangement. This allocation is not permanent and varies annually depending on the maximum supply needs of EU refineries. Imported quantities of SPS receive 85% of the guaranteed price of Protocol Sugar. The SPS was renewed in 2001 for the lifetime of the Sugar Regime (to 2006).

As with the Banana Regime, there are a number of internal and external pressures that have made reform of the Sugar Regime inevitable. Pressures include:

- reducing tariffs on non-Protocol imports (Uruguay Round Agreement on Agriculture);
- reducing domestic support for sugar producers and eliminating export subsidies (July Framework Agreement, WTO);
- increasing imports from non Sugar Protocol countries (Everything But Arms);
- the possibility of extending duty free access to non-Protocol countries (Economic Partnership Agreements under the Cotonou Agreement); and
- reducing support prices to EU sugar farmers (European Commission proposals, July 2004).

### **The economic impacts in ACP countries arising from reform of the EU's banana and sugar markets**

#### *Bananas*

The impact of preference erosion on the ACP countries arising from reform of the EU's banana market depends on the importance of banana production to those economies and the level of tariff that will be introduced. Over recent years, tourism in the Caribbean witnessed average growth rates of 9% per year, helping to mitigate the impacts of preference erosion over the past 10 years for some countries. The proposed third-country tariff of €230/tonne would maintain the Windward Islands' share of the EU market while African ACP suppliers (and possibly the Dominican Republic) might be able to increase exports to the detriment of Latin American countries (under the existing tariff quota, African ACP countries are prevented from exporting more). It is debatable whether Latin American producers and US multinational companies will accept such a high tariff (which would reduce Latin American exports by a third). In order, therefore, to avoid another WTO dispute the EU may have to opt for a lower tariff level. A tariff of €125/tonne would offer some degree of protection to banana production in Belize and Jamaica but production in the Windward Islands would cease or be obliged to move to higher-value niche markets. Losses for the Caribbean ACP countries as a whole would be in the region of US\$100 million per annum, compared to current earnings from banana production.

#### *Sugar*

The importance of income transfers from the Sugar Protocol both in absolute and relative terms varies significantly across the Protocol countries. The total transfers to the ACP Sugar Protocol countries associated with quota access to the protected EU market is about US\$500 million or about 60% of the value of these countries' sugar exports to the EU. Transfers are concentrated on five quota-holders (Mauritius, Fiji, Guyana, Jamaica and Swaziland), which receive over three-quarters. For all five countries the Protocol makes a significant contribution to foreign exchange earnings, but in relative income terms the transfer arising from the Sugar Protocol is most important for Guyana, contributing approximately 10 percent to GDP. Under the current proposals for reform, the real price offered to ACP Sugar Protocol producers will be substantially reduced. This will result in sugar production in a number of higher-cost ACP Protocol countries (Barbados, Côte d'Ivoire, Jamaica, Madagascar, St. Kitts and Trinidad) becoming less profitable without effective investment in cost-saving production. Other countries (Guyana, Fiji and Mauritius) may have to reduce their production levels in order to concentrate on their most lucrative markets and most efficient producers or restructure in order to remain competitive. However, production in a number of ACP countries which are classified as Least Developed (e.g. Republic of Congo; Zambia) or with sufficient exports to non-EU markets (Côte d'Ivoire) may gain from an EU-reform induced rise in the world price of sugar or unlimited access to the EU market (via EPAs or EBA).

### **Transitional assistance for preference erosion**

While the estimated effects of preference erosion arising from the proposed changes to the EU's sugar and banana markets can be expressed in terms of changes in imports or income transfers from the EU to the ACP countries, a wider question arises as to how transitional assistance could be provided to facilitate the necessary adjustment in the most adversely affected Protocol countries.

### *Lessons from existing schemes*

Clearly, no matter how well a scheme is designed it can be offered and used efficiently or inefficiently but lessons can be learned from instruments the EU has used in the past to support commodity-dependent developing countries, not only various forms of trade preferences but also STABEX and, in particular, those to facilitate adjustment in Caribbean countries adversely affected by preference erosion arising from previous reforms to the EU's Banana Regime e.g. the Special Framework for Assistance. These schemes have been criticised for supporting production of declining commodities in countries that have only limited potential to become competitive. Where funds have been allocated for diversification into more productive sectors these have often been only for small-scale pilot projects and have failed to address the key constraints. In addition, strict and often inconsistent conditionality on the use of funds has led to delays in payments and frequent changes to the schemes have hampered investment decisions.

### *Options for transitional assistance*

There are a number of trade and financial mechanisms for transitional assistance that could be used by the EU in supporting ACP Protocol countries although there is no single approach to assisting all countries, and even within individual countries a mixed approach may be required.

Although postponing reform of the EU's Sugar Regime is attracting increasing support from a number of Caribbean countries and sympathy from some in Europe, delay cannot be classified as transitional assistance since countries must still face the costs of adjustment. In addition, such a strategy would be unsustainable given the pressures for reform and the widespread global view that tariff preferences distort international trade and are developmentally wrong because they adversely affect those producing-countries (often poorer than in the Caribbean) that do not receive them. As such, other options must be considered.

Transitional assistance measures could take the form of trade or financial mechanisms or a combination of both. Table 1 summarises the advantages and disadvantages of each.

*Trade measures:* Trade-based transitional assistance measures, entailing no *direct* budgetary cost, could reallocate preferential tariff quotas (for sugar) from those countries that have already restructured production and are willing to forfeit quotas to other Protocol beneficiaries. Alternatively, trade measures could provide for improved market access for other products, especially services (e.g. tourism) to encourage diversification into more profitable activities. There are also high estimates for potential developing country gains arising from developed countries liberalising mode 4 (temporary movement of natural persons) under the GATS. If mode 4 liberalisation were possible, such gains could reduce the net losses for a number of ACP Protocol countries.

*Financial measures:* Any trade preferences bring with them the threat of future preference erosion. Financial solutions must also be found. One option would be for the EU to abandon its past reservations and provide some form of direct aid to ACP banana and sugar producers to compensate them for loss of preferences. This, however, is economically and politically problematic. In particular, there is no justification on welfare grounds to provide additional income to groups who are damaged by trade over those who are adversely affected by other shocks or are simply poor. Compensation also perpetuates dependence and may actually provide adverse incentives if used to delay restructuring and diversification. It is imperative therefore that transitional assistance measures not simply compensate for lost income transfers but facilitate the necessary adjustment in productive sectors.

This means that for countries where production remains viable, support could be provided for restructuring. This could mean increasing the competitiveness of the declining sector (including branding and niche marketing opportunities) or developing related products e.g. ethanol from sugar. Niche markets (such as Fair Trade or organics) provide a price premium which could allow some ACP countries to maintain production. However these approaches may be unable to preserve significant levels of output for those countries whose long-term competitiveness is in decline. In the long run, diversification into other activities is the best strategy for high-cost ACP Protocol countries. Although the inability to diversify into new sectors could be hampered by characteristics such as vulnerability to natural disasters, topographical features and smallness, diversification would reduce risk and bring more stable export revenues.

There is a need to support countries during the transition period and in making the necessary investments for new productive activities. Support for these measures could be channelled through the private sector, national governments, regional organisations or multilaterally. Unless support can be de-linked from production, providing transitional assistance to the private sector would risk offsetting the incentives for diversification and crowding out private investment. In general, therefore, national governments would be better placed to decide upon and implement adjustment strategies. Regional organisations could also contribute by engaging in activities where there are recognised economies of scale such as in the creation of regional research programmes and marketing organisations. A multilaterally administered scheme dedicated to preference erosion could also be sought, assisting all developing countries for all sectors but it is questionable whether this could be found in the timeframe available for sugar reform.

Two crucial decisions would concern country allocation criteria and the duration of support. The former should be linked to the loss of income transfers arising from preference erosion and fixed to offer predictability for recipients. The latter would need to be negotiated although an adjustment period of up to 10 years, with transitional support declining in a pre-determined and predictable way.

#### *Funding*

Funding for transitional assistance could be provided from a variety of existing sources. First, it could be financed by increasing aid, including through the European Development Fund. This might not be justifiable since the allocation among countries would need to be based on losses from preference erosion which could conflict with traditional aid criteria (allocating funds to the poorest countries). Second, it could be made through concessional lending from the European Investment Bank but highly indebted countries may be unwilling to take out additional loans.

Given these potential drawbacks, there may be a need to develop new sources of funding to finance transitional assistance measures. There have been proposals to introduce a consumer levy on sugar to raise the necessary revenue but a more secure method would be the creation of a dedicated line in the EU's budget for transitional assistance to the ACP Protocol countries. This would ensure that additional resources over and above existing aid allocations were being made available and send an important political message to the ACP Protocol countries.

#### *Conclusion*

Although bananas and sugar have become characteristic products of the Caribbean, their importance in national income and exports will decline as a result of preference erosion and (often as a response to this) diversification into more productive sectors such as manufacturing and services which has already begun and will continue.

Previous schemes to compensate for loss of export earnings and to provide finance for restructuring, such as the SFA and STABEX have only had limited success both in terms of the way funds have been used and administered. Where direct compensation has been provided to affected sectors this has often served to aggravate dependence and delay reform rather than facilitate adjustment. Future support needs therefore to be de-linked from production. In addition, previous schemes have often been subject to changes and conflicting conditionality: any scheme must be predictable to encourage its use and strict conditionality should be avoided in order to quicken disbursements. Finally, financing has often been provided following the shock although the effectiveness of support for transitional assistance would be enhanced by financing *ex ante* the required investments.

There are a number of options for transitional assistance that could be provided by the EU in supporting the ACP Protocol countries adjust to its reforms. Although there is no one-size-fits-all approach, and even within individual countries multi-track strategies may be required, some measures may be more suitable for some. For higher production cost countries the greater emphasis would be on diversification while for other countries, where there remains scope for improving competitiveness, support could be provided for restructuring, branding and marketing and diversification into niche and related products.

**Table 1: Options for Transitional Assistance**

<b>Instrument</b>	<b>Type</b>	<b>Where suitable</b>	<b>Advantages</b>	<b>Disadvantages</b>
Trade	Delay reform	Production remains viable at the margin, restructuring has already started & cost savings will <i>shortly</i> come into effect	<ul style="list-style-type: none"> <li>• Politically acceptable to the Caribbean ACP</li> <li>• No budgetary cost</li> </ul>	<ul style="list-style-type: none"> <li>• Future threat from preference erosion - countries must still face the costs of transition</li> <li>• Distorts international trade</li> <li>• Adversely affects poor countries that do not benefit from preferences</li> <li>• Cost to EU consumers</li> </ul>
Trade	Quota redistribution	Countries with quotas are willing to forfeit them to increase other Protocol beneficiaries' quota shares	<ul style="list-style-type: none"> <li>• Some losses offset for those Protocol beneficiaries receiving increased quota share</li> <li>• No budgetary cost</li> </ul>	<ul style="list-style-type: none"> <li>• Most Protocol beneficiaries would be unwilling to forfeit quotas</li> <li>• The most willing would be those with the smallest quotas (generating small income transfers)</li> <li>• Future threat from preference erosion- countries must still face the costs of transition</li> <li>• Cost to EU consumers</li> </ul>
Trade	Improved market access for other products / services (including mode 4)	Infant industries & potential migrant workers have the ability to develop international competitiveness but are limited by trade restrictions	<ul style="list-style-type: none"> <li>• Expansion of exports in new sectors could offset losses from preference erosion</li> <li>• Expansion of non-agricultural exports could reduce commodity-dependence &amp; its associated problems i.e. declining &amp; volatile prices</li> <li>• Worker remittances (mode 4) directly replace export earnings from traditional exports</li> <li>• Limited budgetary cost (tariff reductions)</li> </ul>	<ul style="list-style-type: none"> <li>• If preferences are used instead of multilateral liberalisation countries may become dependent on preferences in new sectors &amp; trade is distorted</li> <li>• ACP countries may be unwilling to negotiate additional preferences outside the context of EPAs</li> </ul>
Financial	Support for the companies currently producing the commodity	Companies have the potential to move into new products	<ul style="list-style-type: none"> <li>• Directly targets losers from preference erosion</li> <li>• <b>Strengthens the private sector</b></li> </ul>	<ul style="list-style-type: none"> <li>• Budgetary cost</li> <li>• Companies which have not diversified already may be ill-suited to do so</li> </ul>
Financial	Support for improving the competitiveness of the bulk commodity e.g. relocating production from high-cost to low-cost areas, investment in research & infrastructure, branding & marketing	Industries where production could remain viable under reduced trade preferences	<ul style="list-style-type: none"> <li>• No threat from future preference erosion</li> <li>• Directly targets the industry &amp; the jobs that depend on it</li> </ul>	<ul style="list-style-type: none"> <li>• Budgetary cost</li> <li>• Limited effectiveness of previous attempts e.g. for bananas, the SFA</li> <li>• Governments may be unwilling to back unpopular reforms</li> <li>• Risk of crowding out private investment</li> </ul>
Financial	Support for diversification into commodity-related products (e.g. ethanol for sugar) or speciality products (e.g. bagged, branded)	Industries where production could remain viable under reduced trade preferences	<ul style="list-style-type: none"> <li>• No threat from future preference erosion</li> <li>• Higher priced products could compensate for the loss in income arising from preference erosion on bulk commodity exports</li> </ul>	<ul style="list-style-type: none"> <li>• Budgetary cost</li> <li>• Risk of crowding out private investment</li> <li>• May not be viable if there are large low-cost competitors on the world market, especially if traditional commodity costs are a significant share of the price of the alternative commodity</li> </ul>
Financial	Support for Fair Trade or organic production	Industries where production could remain viable under reduced trade preferences	<ul style="list-style-type: none"> <li>• No threat from preference erosion</li> <li>• Price is not the sole criterion for purchase</li> <li>• Premiums can directly support poor farmers</li> </ul>	<ul style="list-style-type: none"> <li>• Budgetary cost</li> <li>• Niche marketing requirements e.g. inspection &amp; certification could be costly for small producers</li> <li>• Success greatly depends on price premium &amp; the number of competitors</li> <li>• Unlikely to secure significant share of conventional markets &amp; output</li> </ul>
Financial	Support for diversification into other agricultural products	High-cost countries where production will not be viable following preference erosion	<ul style="list-style-type: none"> <li>• No threat from future preference erosion</li> <li>• Agricultural employment</li> <li>• Maintain export revenues</li> </ul>	<ul style="list-style-type: none"> <li>• Budgetary cost</li> <li>• Topographical characteristics of many small island states hinder agricultural diversification</li> <li>• Many products would also face either intense competition on the world market or restrictive trade barriers</li> </ul>
Financial	Support for diversification into manufactures & services	High-cost countries where production will not be viable following preference erosion	<ul style="list-style-type: none"> <li>• No threat from future preference erosion</li> <li>• Reduced risk &amp; more stable export revenues</li> </ul>	<ul style="list-style-type: none"> <li>• Budgetary cost</li> <li>• Small countries may face higher business costs</li> <li>• Established international players may provide fierce competition</li> </ul>

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