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**COMMUNICATION FROM THE COMMISSION
TO THE COUNCIL AND THE EUROPEAN PARLIAMENT**

accomplishing a sustainable agricultural model for Europe through the reformed CAP – sugar sector reform

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1. INTRODUCTION AND SUMMARY

The present sugar regime is often subject to fierce criticism for a lack of competition, distortions in the market, high prices for the consumers and users, and its effect on the world market, particularly in relation to developing countries. Yet, despite calls for reform, it has remained essentially unchanged for four decades.

The success of the new orientation of the CAP, which moved away from price and production support to a more comprehensive policy of farmer income support through the single farm payment scheme, has added a new dimension to the need for sugar reform

If unchanged, the EU sugar policy will become an anomaly deviating from the fundamental principles of the new Common Agricultural Policy (CAP) – market orientation, decoupled farm income support, and a better balance between the two pillars of the CAP via the strengthening of rural development.

The public debate following the publication of the Commission's September 2003 Communication[1], and accompanying Extended Impact Assessment on the Sugar Sector[2] on the options for reform of the EU sugar regime, has confirmed both the urgent need for a significant reform in the sector and the complexities that such a reform would entail.

On the one hand this debate has highlighted that, despite claims that the fixed nature of the EU sugar policy is proof of its good functioning, the status quo is no more sustainable. The gap between EU and world market prices has grown larger, while the EU undertook new international commitments. In these conditions, the structural surplus of the EU risks widening while the rigidity of the present quota system leaves no incentive for the sector to adjust.

On the other hand expectations about the positive impact of any reform are sometimes over simplistic. For example, the necessary restructuring of the sector will not affect in the same manner all sugar producing regions in the EU. Similarly, the prospect that not just potential winners, but also potential losers from developments in the EU sugar market, with or without reform, are to be found among the developing countries raises serious questions about how to deal with this issue.

The Commission, in developing the current proposal, has taken into account three important elements.

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1 COM(2003) 554 final.
2 SEC(2003) 1022.

1. While the proposal represents a necessary step in terms of sugar reform, experience from CAP reform in other sectors has demonstrated that it needs to be balanced.

2. EU producers and trade partners should be provided with realistic perspectives about their long-term future.

3. The possibility for further reform should be reviewed in the medium-term, when a series of factors, surrounded by uncertainty at this stage, will be clearer and better known.

Against this background, it is clear that the objectives of the reform should be those of the recent overall approach to CAP reform. A sustainable long-term policy perspective must be given. This, in turn, must be based upon improved competitiveness, greater market orientation and a sustainable market balance consistent with the EU’s commitments, with respect to third countries and international trade rules. These objectives must be achieved whilst ensuring that account is properly taken of producer incomes, consumers’ interests and the situation of the processing industry, in particular the need for a period of transition to permit the necessary adjustments. These objectives will be reached through a reform based on the combined elements of significant price reduction, abolition of intervention, reduction in quotas and quota transferability.

In concrete terms, the Commission proposes the following:

- A significant reduction, in two steps, of the institutional support price for EU sugar with the abolition of intervention and the introduction of a reference price. This reference price will serve in the establishment of the minimum price of sugar beet producers, the trigger level for private storage, the level of border protection and the guarantee price under the preferential import mechanism. A price reporting mechanism for the EU market will have to be put into place rapidly.
- The introduction of partial compensation for producers in the form of a direct decoupled payment within the CAP budget limits, with the same historical reference period, as used in the 2003 CAP reform (2000–2002). This payment will be integrated into the single farm payment scheme.
- Simplification of the present quota system by merging the A and B quotas into one quota and the reduction of the resulting total quota level, in order to reach a sustainable balance on the EU sugar market. The C sugar provisions will remain as at present.
- Restructuring of the EU sugar sector through transferability of quotas between Member States and the introduction of a sugar factory conversion scheme, in order to facilitate the necessary adjustments and smoothen their impact.
- Modification of the import regime for Western Balkans, in order to provide EU partners with a clear framework which, while allowing the respect of present trade concessions, prepares their sector for the adjustments needed to perform within a realistic and economically sustainable environment.

In addition, the proposal will provide the basis for initiating a structured dialogue with EU partners in the developing world on the sugar sector, in order to consider the manner by which the EU can best contribute to the necessary and inevitable adjustments in sugar production in African, Caribbean and Pacific (ACP) countries and India.

Finally, whilst the Commission is committed to the fundamental direction of the present reform, it is clear that, while some elements such as the Everything but Arms (EBA) agreement are fixed, this proposal cannot take full and precise account of all possible future international developments which could affect the sector. The outcome of the Doha round, the challenge of elements of the present sugar regime in a panel before the World Trade Organisation (WTO), the future of ethanol production and the prospects for world market price development all indicate that the EU sugar market should be re-examined when more is known in these areas of uncertainty. For these reasons, the Commission proposes to review the price and quota levels of the proposed reform in 2008.

2. PROPOSED REFORM OF THE EU SUGAR REGIME

The findings of the Commission's Extended Impact Assessment point to an unsustainable future for the current EU sugar sector. In particular, the maintenance of current high EU prices will dramatically increase sugar imports at the expense of domestic EU production. The current regime would reduce relatively more the sugar production under quota in the EU's most competitive sugar producing regions, with relatively higher levels of B-sugar, compared to the less competitive ones, with smaller B quotas.

Such a situation would lead to a gradual attrition of the EU sugar sector and bring it into even greater contradiction with the prevailing direction of CAP Reform, just when reformed sectors would be improving their competitiveness and market orientation.

2.1. Providing a clear policy perspective for the EU sugar sector

The necessary steps must be taken now to incorporate the EU sugar CMO into the CAP reform process by:

- integrating the EU sugar sector into the sustainable, long-term policy perspective established for agriculture, in line with its present budgetary envelope, the ceiling of Heading 1a of the current financial perspectives, the framework for agricultural expenditure and the modulation and financial discipline mechanisms;
- improving the competitiveness of the EU sugar sector by reducing significantly institutional support prices and simplifying the current quota arrangements, thereby making way for an economically sustainable EU sugar production base;
- giving priority to producer income support by transferring part of the current support for the EU sugar sector to the single farm payment scheme;
- subjecting these payments, as is the case with all CAP direct payments, to the respect of the statutory EU environmental and food safety standards, through cross-compliance, and rules of good agricultural and environmental condition, as well as to the modulation mechanism.

2.2. Promoting a more market-oriented, sustainable EU sugar sector

2.2.1. Prices

Intervention

In the current sugar CMO, intervention has hardly ever been an active regulatory instrument. It is therefore appropriate to move away from a public intervention mechanism, as has been done for other sectors since 1999. Thus, it is proposed to abolish the intervention mechanism and intervention price for sugar.

Reference Price

The intervention price will be replaced by a reference price for sugar. Since the EU intervention price has for many years been out of touch with world trends and, at its current level of 632 EUR/t, is more than three times the prevailing world sugar price, a reference price will be set at a level one third lower than the current intervention price. It will be phased in, in two steps, over three years, beginning in the 2005/06 campaign.

The reference price will serve in the establishment of the minimum sugar beet price for producers, the trigger level for private storage, the level of border protection and, finally, the guarantee price under the preferential import mechanism.

Minimum Sugar Beet Price

Currently, the average, weighted sugar market price, at which the EU sugar factory sells its sugar, is estimated at 655 EUR/t, that is, somewhat higher than the current intervention price of 632 EUR/t. Under the present proposal, the sugar market price is projected to fall to the level of the new institutional price of 421 EUR/t, that is, an effective price reduction of 36%. In order to keep a parallelism between the price cuts at farm, factory and refinery level, the minimum sugar beet price, which is the price paid to farmers for their sugar beet, has been established taking into account a similar percentage reduction in the effective price of both sugar and sugar beet. The schedule for the price reductions is given in Table 1.

Table 1 – Proposed Institutional Prices in the EU Sugar Sector

	Reference period	2005/06	2006/07	2007/08
Institutional Sugar Price (EUR/t)	632	506	506	421
Cumulative reduction in institutional price	0.0%	–20.0%	–20.0%	–33.0%
Minimum Sugar Beet Price (EUR/t)	43.6	32.8	32.8	27.4
Cumulative reduction in minimum sugar beet price	0.0%	–25.0%	–25.0%	–37.0%

Price Reporting

The Commission will come forward with a proposal for a price reporting mechanism for sugar, which will be put into place by the Commission, in time for operational use as from the 2005/06 campaign.

2.2.2. *Quotas*

Quota Reductions

Through the functioning of the existing quota arrangements, it has been possible for the EU sugar market to maintain a market situation where production in the EU systematically exceeds domestic consumption. While sugar produced under A and B quotas benefits from the same institutional price, B quota sugar is subject to a much higher levy because it corresponds to that volume destined for export with refund. Sugar produced above the A and B quotas is the so-called C sugar, which has to be sold on the world market without any support. In the context of the 2003 reform and its emphasis on market orientation, highly subsidised exports are no longer economically sustainable.

Consequently, starting in 2005/06, it is proposed to bring the production quota in line with internal consumption, taking into account the impact of the new arrangement for the chemical and pharmaceutical industries on their use of sugar under quota, by initially reducing the current sugar quota of 17.4 million t by 1.3 million t and subsequently, from 2006/07, in three annual linear reductions of 0.5 million t per year, bringing the cumulative reduction of the production quota to 2.8 million tonnes by 2008/09.

Quantities (*million tonnes*)		**Base year**	**2005/06**	**2006/07**	**2007/08**	**2008/09**
Consumption	C	16,3	16,1	16,1	16,1	16,1
Quota	Q	17,4	16,1	15,6	15,1	14,6
EU production under quota	P	17,3	16,0	15,5	15,0	14,5

Quota Simplification

In this context, to simplify the quota arrangements, the A and B quotas will be merged into one single quota. The C sugar provisions will remain as at present.

Isoglucose

Owing to the relationship between the isoglucose and sugar markets, the proposed price reductions will also impact on the EU isoglucose sector revenue. Therefore, the isoglucose sector will need to be in a position to profit from economies of scale, in order to have a long-term prospect of economic viability. Under these circumstances, a progressive and proportional increase of isoglucose quotas, of 100 000 t/year for three years beginning in 2005/06, is proposed.

2.2.3. *Market Balance Tools*

Abolition of the declassification mechanism

In view of the overall objective of improving competitiveness and market orientation, the current declassification mechanism would no longer be appropriate as a means of intervening to balance the market. In fact, the declassification mechanism of quota sugar into C sugar results in a sharper reduction in B than A quota, thus placing more pressure on the most competitive sugar producing Member States, which produce the highest share of B quota. In the presence of prospects for increased imports, this effect would be intensified, contributing to the decline of the EU sugar sector under the status quo scenario. It is therefore proposed to abolish this mechanism.

Private Storage

A private storage scheme, implemented by a Commission tender procedure and triggered when the market price falls below the reference price, will open the possibility of withdrawing sugar from the market.

Carry-over Mechanism

In addition to the private storage mechanism, the Commission will still have the possibility of dealing with market imbalance by carrying over any surplus volume to the following campaign, counting against the quota of the sugar producer. Should such a situation arise, the Commission proposes that the volume carried over will be deducted through a pro-rata reduction in quotas, to be applied across the board.

2.2.4. Specific measures for the chemical and pharmaceutical industries

It is proposed that the current arrangements for excluding the sugar used for alcohol, including rum, bio-ethanol and yeast production from the production quotas will continue and will be extended to those quantities of sugar used by chemical and pharmaceutical industries, for end products with a high utilisation of sugar. Since the proposed arrangement will permit these industries to be supplied with sugar at a competitive price (close to world market price), the refunds for use of sugar in the chemical and pharmaceutical industries are no longer needed. Therefore, production refunds will be abolished, as from 2005/06 onwards.

2.2.5. Restructuring

Quota Transferability

In the light of the proposed price reductions, analyses indicate that, in regions where the sugar market price remains above the combined costs of growing and processing sugar beet, sugar production will continue, albeit with some change in investment strategy. However, factories operating in regions of low competitiveness will face long-term negative margins. Quota mobility is currently limited within a Member State and therefore impedes the relocation of sugar production from the least competitive sugar producing Member States to the most competitive.

Therefore, it is proposed that modifications be introduced in the rules governing the sugar quota distribution, permitting transferability between Member States of the sugar quotas. In the case of such transfer, the seller of the quota will remain liable for the environmental condition of the factory site and the redeployment of the workforce.

Conversion Scheme

For those factories, which, in the light of the price reductions, are no longer economically viable and whose quota is not taken up by another operator, a safety net scheme is proposed, to participate in the financing of the costs associated with restoring the good environmental condition of the factory site and the redeployment of the workforce.

Such a scheme will operate at Member State level. It will begin in 2005/06, last for five years and the payment will be paid once only. The EU co-financing of the scheme will be up to 50% (75% in Objective 1 areas) of a unit amount of 250 EUR/t of sugar processed under quota by the beneficiary. In this case, the quota corresponding to the closed factory will be cancelled. The financial envelope necessary for implementing a national programme under the scheme will be calculated annually on the basis of Member State requests.

2.2.6. Direct Income Support for Sugar Beet Producers

The proposed price cuts will lead to a significant income loss to sugar beet producers. In order to offset that loss, at least partially, it is proposed to set up a direct payment system in this sector by transferring a part of the EAGGF expenditure for sugar, into the funding of the single farm payment scheme. The annual payment will be introduced in two steps, one payable in 2005/06 and 2006/07 and one payable as from 2007/08. The payments will only be granted to farmers who produced sugar beet under quota in the historical reference period and will not be affected by any quota transfers, which may be made subsequently.

The revenue loss was estimated taking into account the change in the weighted minimum sugar beet price in each Member State, which reflects the different combinations of sugar produced under A and B quota. The national envelopes for the direct payment, which amount to 60% of the estimated revenue loss, are given for each Member State in Table 2. In the calculation of the compensation, farmers of all Member States are treated in an equal manner.

Table 2 – Envelopes for Direct Income Support for Farmers (*million EUR*)

Payment steps	B	DK	D	EL	E	F continental	IRL	I
in 2005/06 & 2006/07	41	19	154	18	60	150	11	80
from 2007/08	62	30	241	26	86	234	16	119
	NL	**A**	**P continental**	**FIN**	**S**	**UK**	**F* overseas**	**P* Azores**
in 2005/06 & 2006/07	41	19	4	8	21	64	27	1
from 2007/08	63	29	6	12	30	93	39	1
	CZ	**HU**	**LV**	**LT**	**PL**	**SK**	**SI**	**EU-25**
in 2005/06 & 2006/07	28	25	4	7	99	12	3	**895**
from 2007/08	39	36	6	9	142	17	4	**1 340**

* Includes amounts corresponding to current disposal measures

Member States shall incorporate the direct payments into the single farm payment and may do this either on the basis of the sugar beet area, corresponding to the sugar beet produced under quota, during the historical reference period, or on the basis of the total sugar beet area during the same period. As in the 2003 CAP reform, in cases where the single farm payment has been regionalised, Member States may also apply flexibility in defining the balance between individual payments and regional or national averages.

Furthermore, outermost regions will also benefit from a special treatment, taking into account the specific constraints of their agriculture and sugar industry, as well as their logistic situation in relation to the EU market, and from the possibility to exclude the direct payments from the single farm payment scheme, as is already the case for the other reformed sectors[3].

2.3. Responding to the EU's International Commitments

The challenges posed by the international commitments of the EU sugar regime raise complex questions because any reform of the EU sugar CMO is bound to generate both winners and losers, within the developing world. Such questions should not be addressed simplistically or hastily as they require an open and structured dialogue with EU partners, with all relevant parameters discussed.

The present proposal allows some of the crucial parameters of this dialogue, such as the internal EU price support or the EU quota level, to be clarified. Although other parameters, including the outcome of the Doha round and the WTO panel, would only become clearer as this dialogue proceeds, there should be no doubt about the need to address now the immediate challenges of the EU's international sugar commitments.

Already today, world sugar price developments are mainly affected by excess supply, with the increase in production and exports of Brazil alone accounting for the bulk of the recent decline in world prices and introducing challenges for the competitiveness of many other developing countries. While the Everything but Arms (EBA) initiative provides real prospects for significant sugar exports from some of the poorest developing countries to the EU, it has also generated concerns of potential erosion of the ACP countries and India preferences.

Finally, the significant increase in EU imports from the Western Balkans, which remain net sugar importers, raises questions about the economic sustainability of such trade flows, especially with respect to benefits of their local economy, in the light of the proposed reform of the EU sugar CMO.

The Commission considers that, in addressing the challenges related to the EU's international commitments on sugar, the implementation of the EBA initiative, and its expected impact, should be a fixed parameter in the debate with its ACP and India partners.

Within this framework, the Commission takes it as granted that the provisions of the current ACP sugar protocol and India agreement, which commit the EU to buy annually at a guaranteed price an agreed quantity of 1.3 million t of white sugar equivalent, will be retained. To account for changes under the present proposal, this commitment will now have to be fulfilled at a lower guaranteed price for white sugar,

3 In the framework of this reform, funds currently specifically earmarked for support of Outermost regions' sugar will be maintained.

equal to the EU reference price. At this price level, the implied raw sugar price will be 329 EUR/t, a level indicating that the refining aid will no longer be needed for refiners and will thus be repealed.

In the framework of the debate, which has been launched by the Commission with its Green Paper on Preferential Rules of Origin, the Commission will consider coming forward with a proposal concerning the implementation of rules of origin in the case of the sugar trade, in particular to prevent abuse of these rules.

To avoid distortion of competition with Least Developed Countries (LDCs) benefiting from the EBA agreement, the sugar to be imported within that EBA scheme will continue to be compulsorily bought by EU operators at a price no lower than the guaranteed price for ACP countries and India sugar.

Finally, in order to uphold the benefits to the Western Balkans of the EU sugar import regime, while at the same time providing a sustainable framework for the sugar sector of these countries that is consistent with their long-term orientation towards the EU, the Commission proposes the introduction of a tariff rate quota at levels that preserve their present export levels to the EU and the prospects of an economically sustainable balance between their production and consumption.

The implementation of the Commission proposal would certainly imply adjustments in the sugar sector of the ACP countries and India. The Commission will initiate a dialogue with the Sugar Protocol countries (and India) on the basis of an action plan to be proposed before end 2004, in order to define appropriate accompanying measures. These should correspond to both the trade and development measures. As regards trade measures, the Cotonou Agreement foresees the review of the Sugar Protocol in the context of EU-ACP negotiations on Economic Partnership Agreements (Article 36.4). The Sugar Protocol should be integrated into the EPAs in such a way that does not prejudge the EU's commitment to LDCs for full market access for sugar from 2009 and that ensures full compatibility with WTO rules. As regards development assistance measures, the Commission will propose the introduction of specific measures to help Sugar Protocol countries/India to adapt to the new market conditions. Such programmes should focus on improving the competitiveness of the sugar sector where economically viable, and on supporting diversification, where improvements in competitiveness in the sugar sector are not sustainable[4].

In the light of these price guarantees and the preferential tariff for ACP countries and India, and non-limited access arrangements at zero tariff as from 2009/10 for EBA countries, the Maximum Supply Needs (MSN) instrument will in time no longer be needed.

However, as is currently the case for ACP countries and India, it will be necessary to continue monitoring sugar imports and their origin country by country.

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4 Financing of such measures will be ensured through mobilising the flexibility instrument up to end 2006, and then by a thematic appropriation within the « Development Cooperation & Economic Cooperation » Instrument as proposed for the next financial perspectives 2007-2013.

3. THE IMPACT OF THE PROPOSED REFORM

3.1. Budgetary Impact

The annual costs of the proposed reform remain within the status quo expenditure scenario established by the Commission when, at the time of the CAP Reform proposals of January 2003, it presented expenditure forecasts for the CAP for the period to 2013. The costs for the CAP of the new measures proposed for this sector, for which the direct decoupled payment to producers represents the major element, will be offset by the savings resulting from a substantial reduction in export refund expenditure and from the abolition of the production refund for the chemical and pharmaceutical industries and of the refining aid.

When the proposed measures for the sector have been fully implemented, the envelopes for direct income support will involve an annual cost of 1 340 million EUR, whilst expenditures in respect of exports refunds for sugar and exports refunds for sugar contained in exported processed products, are estimated at about 100 million EUR each. However, this latter figure would be lower if the conversion scheme leads to the cancellation of significant amounts of quota and a corresponding reduction in export quantities. Any costs in respect of the private storage scheme should be limited and only arise if market prices risk falling significantly below the reference price.

As far as own resources are concerned, 75% of the amounts raised by the system of production levies accrue as revenue for the budget (360 million EUR for the 2004 budget). In future, this revenue will be reduced sharply and even disappear as the automatic consequence of bringing sugar quota production into line with EU consumption.

3.2. Economic Impact

Despite significant internal price reductions which should benefit the consumer, a marginal adjustment to consumption of sugar under quota is expected, as a result of the new arrangement for the use of sugar by the chemical and pharmaceutical industries.

Due to the increased competitiveness of EU sugar production, an increase in imports of only 0.5 million t, that is from 1.9 to 2.4 million t of sugar, from preferential partners, is forecast. Given a stabilisation of the import regime for the Western Balkans, the main driver of the increased level of imports would be the impact of the zero tariff arrangements of the EBA agreement for LDCs.

It is projected that the combined, aggregate effect of the proposals on support price and quota reduction would be a significant reduction in the level of EU production under quota**,** from 17.3 to 14.5 million t per year. Under these conditions, it may be expected that sugar beet cultivation will not continue in all production regions of the EU.

Furthermore, as a consequence of the substantial reduction in the overall level of EU production, EU subsidised sugar exports are projected to fall by around 2.0 million t.

4. TIMETABLE AND REVIEW OF THE PROPOSED ARRANGEMENTS

In this Communication, the Commission has proposed important changes to many of the instruments of the current EU sugar regime.

The Commission considers that, in view of the pressing need to lay the foundations of a new sugar regime, to provide a new perspective for the long-term investments in the EU sugar sector and to address the already decided trade impacts, the set of proposals outlined above must be of immediate application, beginning in the 2005/06 campaign for a period of three years.

However, at this stage, owing to the uncertainty of the outcome of the ongoing WTO round and the real effects of the EBA agreement, the Commission proposes to review the price and quota levels of the proposed reform in 2008.