Forthcoming Changes in the EU Banana/Sugar Markets: A Menu of Options for an Effective EU Transitional Package

Report

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Glossary

ACP	Africa, Caribbean and Pacific Group
c.i.f.	Cost-insurance-freight
CAP	Common Agricultural Policy
CARICOM	Caribbean Community and Common Market
CBI	Caribbean Basin Initiative
COMB	Common Organisation of the Market in Bananas
COMS	Common Organisation of the Market in Sugar
EBA	Everything But Arms
ECJ	European Court of Justice
EDF	European Development Fund
EIB	European Investment Bank
EU	European Union
f.o.b.	Free-on-board
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
IMF	International Monetary Fund
LDCs	Least Developed Countries
MFN	Most-Favoured-Nation
NIP	National Indicative Programme
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
PRGF	Poverty Reduction and Growth Facility
SFA	Special Framework for Assistance
SP	Preferential Sugar
SPS	Special Preferential Sugar
SSA	Special System of Assistance
Tariff quota	A tariff quota is any pre-set value or quantity of given goods, which may be imported during a specified period with a reduction of the normal customs duties, and beyond which any additional quantity of these goods can be imported by paying normal customs duties.
TIM	Trade Integration Mechanism
WIRSPA	West Indies Rum and Spirit Producers' Association
WTO	World Trade Organization

Executive Summary

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 (e.g. CAP reform, challenges in the WTO). Although reducing preferences for banana and sugar exports from these Protocol countries will have beneficial effects on development and poverty reduction in other major producing countries which are not party to these agreements, losses for some Caribbean ACP countries will be significant relative to external income.

Assistance can be justified under the EU's international obligations because it is partially withdrawing from a binding undertaking which was of unlimited duration. In the absence of assistance, countries suffering from changes to the regime may attempt to delay reform to the detriment of those countries which stand to gain. The European Commission is proposing specific measures to assist the Protocol countries in adjusting to changes in the EU's Sugar Regime due to begin in 2006. Such an offer for transitional assistance is well planned, but the EU's commitments under the Cotonou Agreement to ensure the continued viability of the Protocol industries will be difficult, if not impossible, to maintain in higher-cost countries following reform.

Lessons can be learned from the numerous instruments the EU has used in the past to support commodity-dependent developing countries, not only various forms of trade preferences but STABEX and, in particular, those to facilitate adjustment in Caribbean countries adversely affected by preference erosion arising from successive 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 the wider economy. 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.

Although any scheme, no matter how well designed, can be used efficiently or inefficiently, a new fund could be developed to overcome these problems. A dedicated preference erosion scheme could be used to finance investments supporting industry restructuring and export diversification without fixing countries into already outmoded trade and production patterns. The scheme would need to be predictable in order to encourage investment and to avoid strict conditionality to quicken disbursements.

Options for transitional assistance

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-based transitional assistance measures, entailing no *direct* budgetary cost, could reallocate preferential tariff quotas from those countries that have already restructured production and are willing to forfeit their quotas to other Protocol signatories. Alternatively, trade measures could provide for improved market access for other products and 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, but would require the EU's Member States to show unprecedented political tolerance in allowing increased imports of foreign labour.

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

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 to provide some form of direct aid to ACP banana and sugar producers to compensate them for loss of preferences. This, however, may be economically and politically problematic. In particular, there is no justification on welfare grounds to give additional income to groups who are damaged by trade over those who are damaged by other shocks or are simply poor. Compensation also perpetuates dependence and may actually provide adverse incentives if it is used to delay restructuring and diversification. It is imperative therefore that transitional assistance measures should 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 include measures to increase the competitiveness of the declining sector (including branding and niche marketing opportunities) or developing and marketing related products e.g. ethanol from sugar. Niche markets (such as Fair Trade or organics) provide a price premium which could allow some ACP Protocol 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. The Caribbean has already shown some success in diversifying into tourism and financial services, especially in the Windward Islands where the growth of former has more than offset the decline in banana export earnings resulting from successive revisions to the EU's Banana Regime.

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 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 e.g. textiles, but it is unlikely that this could be found in the timeframe available for sugar reform.

Financing and country allocation criteria

Losses arising from preference erosion would be of the order of US$500 million for sugar (and US$100 million for bananas). Funding for equivalent financial 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 soft 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.

Two crucial decisions will 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 will need to be negotiated although an adjustment period of 10 years, with transitional support declining in a pre-determined and predictable way, could be proposed as a reasonable estimate.

Table 1: Options for Transitional Assistance

Instrument	Type	Where suitable	Advantages	Disadvantages
Trade	Delay reform	Production remains viable at the margin, restructuring has already started & cost savings will *shortly* come into effect	• Politically acceptable to the Caribbean ACP • No budgetary cost	• Future threat from preference erosion - countries must still face the costs of transition • Distorts international trade • Adversely affects poor countries that do not benefit from preferences • Cost to EU consumers
Trade	Quota redistribution	Countries with quotas are willing to forfeit them to increase other Protocol signatories' quota shares	• Some losses offset for those Protocol signatories receiving increased quota share • No budgetary cost	• Most Protocol signatories would be unwilling to forfeit quotas • The most willing would be those with the smallest quotas (generating small income transfers) • Future threat from preference erosion- countries must still face the costs of transition • Cost to EU consumers
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	• Expansion of exports in new sectors could offset loses from preference erosion • Expansion of non-agricultural exports could reduce commodity-dependence & its associated problems i.e. declining & volatile prices • Worker remittances (mode 4) directly replace export earnings from traditional exports • Limited budgetary cost (tariff reductions)	• If preferences are used instead of multilateral liberalisation countries may become dependent on preferences in new sectors & trade is distorted • ACP countries may be unwilling to negotiate additional preferences outside the context of EPAs
Financial	Support for the companies currently producing the commodity	Companies have the potential to move into new products	• Directly targets losers from preference erosion • Strengthens the private sector	• Budgetary cost • Companies which have not diversified already may be ill-suited to do so
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	• No threat from future preference erosion • Directly targets the industry & the jobs that depend on it	• Budgetary cost • Limited effectiveness of previous attempts e.g. for bananas, the SFA • Governments may be unwilling to back unpopular reforms • Risk of crowding out private investment
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	• No threat from future preference erosion • Higher priced products could compensate for the loss in income arising from preference erosion on bulk commodity exports	• Budgetary cost • Risk of crowding out private investment • 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
Financial	Support for Fair Trade or organic production	Industries where production could remain viable under reduced trade preferences	• No threat from preference erosion • Price is not the sole criterion for purchase • Premiums can directly support poor farmers	• Budgetary cost • Niche marketing requirements e.g. inspection & certification could be costly for small producers • Success greatly depends on price premium & the number of competitors • Unlikely to secure significant share of conventional markets & output
Financial	Support for diversification into other agricultural products	High-cost countries where production will not be viable following preference erosion	• No threat from future preference erosion • Agricultural employment • Maintain export revenues	• Budgetary cost • Topographical characteristics of many small island states hinder agricultural diversification • Many products would also face either intense competition on the world market or restrictive trade barriers
Financial	Support for diversification into manufactures & services	High-cost countries where production will not be viable following preference erosion	• No threat from future preference erosion • Reduced risk & more stable export revenues	• Budgetary cost • Small countries may face higher business costs • Established international players may provide fierce competition

1. Introduction

The principal objective of this study is to identify a menu of options for an effective EU transitional assistance package to support sugar-dependent ACP countries. This will include references to lessons learned from other existing mechanisms, most notably those to facilitate adjustment in the banana-dependent Caribbean islands following the reforms made to the EU's banana market post-1993.

Whilst the paper will focus on sugar production in the Caribbean region, the menu of options and recommendations will be presented to ensure their relevance to other sectors and transferability to other ACP Protocol countries.

Exports of bananas and sugar have played a major role in the economic history of the Caribbean. The growth of banana exports was in many ways tied to the decline of the sugar sector. In Jamaica and later the Windward Islands bananas were developed by the colonial authorities as a diversification crop to wean the island economies off sugar dependence. However, these traditional sectors will face difficulties on the EU market arising from increased competition (bananas) or from a decline in prices (sugar).

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. Then, as now, sugar production essentially involved only the growing and harvesting of the cane (to produce raw sugar) with the value-added refining and packaging processes being performed in the UK. 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 arrangements (US-Cuba/Philippines, UK-Caribbean, and the Commonwealth Sugar Agreement) divided up the market (Hewitt, 2001). Market segmentation has meant that the free market for sugar has become a small residual (20 percent) of world sugar trade. As a result, the 'world' price of sugar experiences considerable volatility (see Chapter 2).

Colonial preferences designed to continue transferring resources to traditional suppliers but also benefiting rent-seeking intermediaries have evolved into EU policy, not least because British interests were taken into account with the UK's accession in 1973. In the EU banana market, Caribbean ACP countries have enjoyed preferential access, first under bilateral arrangements with individual EU Member States, and since 1993 through the EU common organisation of the market in bananas. Similarly, the Sugar Protocol, which was annexed to the Lomé Convention, has provided access to the protected (higher price) EU sugar market for a number of ACP countries (and India).

Preferential access to the EU's sugar and banana markets has afforded large income transfers to a number of ACP countries (see Chapter 4). These transfers are now under

threat from preference erosion arising from proposed changes to the EU's Sugar and Banana Regimes which have had to respond to a number of internal (e.g. CAP reform) and external (e.g. WTO) pressures (see chapter 3). Eliminating tariff quotas for imports of bananas and reducing the EU sugar price will have very favourable effects on development and poverty reduction in major non-Protocol producing countries. A recurring debate throughout has been that between the Caribbean, arguing the negligible global consequences of preferences and the threat of increased drug traffic as a potential consequence of preference erosion, and those countries favouring reform, highlighting that only a fraction of the benefits of EU preferences actually accrue to producers. Those countries opposed to preferences have also argued that ACP growers cannot continue indefinitely to rely on tariff preferences and that it would be in the interest of the countries concerned for them to be replaced by direct finance to support diversification.

For bananas, the EU's regime has been challenged on a number of occasions by Latin American countries, backed by US multinational companies. Following a series of rulings in the GATT and the WTO against the EU, the banana regime has been modified several times leading to an erosion of Commonwealth Caribbean preferences. In 2006 the EU will introduce a tariff-only trade regime to replace the present tariff-quota system. This will allow duty-free access for ACP bananas, and apply a uniform tariff to bananas originating from non-ACP countries (see Chapter 3).

For sugar, the real price offered to ACP Sugar Protocol producers will be substantially reduced under the EU's current proposals for CAP reform (to begin in 2006). However, Article I of the EU-ACP Sugar Protocol provides that "the European Community undertakes for an *indefinite period* to purchase and import, at *guaranteed prices*, *specific quantities* of cane sugar, raw or white, which originate in the ACP States and which these States undertake to deliver it." In strict legal terms, therefore, the EU is obliged to negotiate the guaranteed price with the ACP Sugar Protocol countries although in practice this obligation has been unilaterally determined by the EU which is (arguably) allowable as the language in Article V approximates the price that can be negotiated to a price "within the price range obtaining in the Community". Regarding the specific quantities, Article III states that "these quantities may not be reduced without the consent of the individual states concerned."

Some ACP countries have used the economic rents associated with preferences to secure long-term efficiency gains by diversifying into new export sectors (e.g. sugar in Mauritius). For other countries (e.g. bananas in the Windward Islands), preferences have stifled diversification by encouraging resource allocations to high-cost production where the increases in income are temporary (see Chapter 5). Where preferences have resulted in resource allocations to uncompetitive sectors, their removal will lead to long-term efficiency gains from diversification into higher growth export sectors. However, in the short-term any large scale reallocation of production could undermine employment and foreign exchange earnings which would impose high adjustment costs.

In determining whether transitional assistance is justified, an important consideration is each country's fiscal, balance-of-payments and debt positions. This is particularly

relevant to the Caribbean which, although containing seven of the ten most heavily indebted countries in the world, consists mostly of middle-income countries (see Table 2). The notable exception to this is Guyana which is now the third-poorest country in the western hemisphere after Haiti and Nicaragua (neither of which is a member of the Sugar Protocol) with a per capita income of US$840 (see Hewitt, 2001 for a discussion).

Table 2: Caribbean poverty and inequality comparison

	GDP per capita 1/ (US$)	**External debt per capita 2/ (US$)**	**Population 3/**	**% of population living on <US$1 per day 3/**	**Gini coefficient of inequality 5/**
Upper-middle income					
St. Lucia	3,840	1,878	159,000	7.1	0.43
Grenada	3,500	4,359	102,000	18.0	0.45
Dominica	3,180	4,779	72,000	13.0	0.49
Lower-middle income					
St. Vincent	2,820	4,579	117,000	25.7	0.45
Belize	2,960	4,055	253,000	13.4	0.51
Jamaica	2,820	2,027	2,613,0000	3.2	0.38
Dominican Republic	2,320	915	8,635,000	3.2	0.49
Suriname	1,960	751	423,000	n.a.	n.a.
Guyana	840	1,622	772,000	19.1	0.45
Low income					
Haiti	440	163	8,286,000	n.a.	n.a.

1/ *Source:* Data relates to 2002 from World Bank (2004b).
2/ *Source:* Data relates to 2002 from OECD (2004).
3/ *Source:* National poverty assessments and living conditions surveys.
4/ *Source:* Windward Islands – World Bank Country Assistance Strategy 2001; Belize – CDB Poverty Reduction Strategy 2000; Dominican Republic, Jamaica and Guyana – World Bank estimates. Gini values closer to 0 indicate more income equality and closer to 1 less equality. By contrast values for Scandinavia are low (0.2), typically 0.3 for many developed countries; most of Latin and Central America have values of approximately 0.5.

Source: Adapted from DFID (2004) and OECD (2004).

Assistance is justified under the EU's international obligations because (in the case of sugar) it is partially withdrawing from a binding undertaking which was of indefinite duration. In its absence, countries suffering from the changes to the regimes may attempt to delay reform to the detriment of those countries which stand to gain (see Chapter 5). This has been aggravated by the EU sending misleading signals over reform. In particular, the Cotonou Agreement signaled the possibility of some modification and change for sugar after 2008. For this reason the ACP Protocol countries assumed that they had at least an eight year period within which to adjust. Three months later, a leaked document advised that reforms would be undertaken much sooner (initially in 2005).

There are also arguments that permanent differences (vulnerability, smallness, remoteness) which serve to raise the costs of production (and trading) obstruct the reallocation of resources into new sectors and reduce the number of diversification opportunities. In addition, sugar is the most hurricane resistant crop and bananas are harvestable all year round thus reducing the need for planned saving. These are particularly compelling given the recent devastation in the Caribbean caused by three hurricanes in September 2004. Grenada, in particular, has been worst affected: the

Organisation for Eastern Caribbean States estimates that the country will need US$900 million to rebuild (over twice its annual GDP).

2. The world markets for bananas and sugar

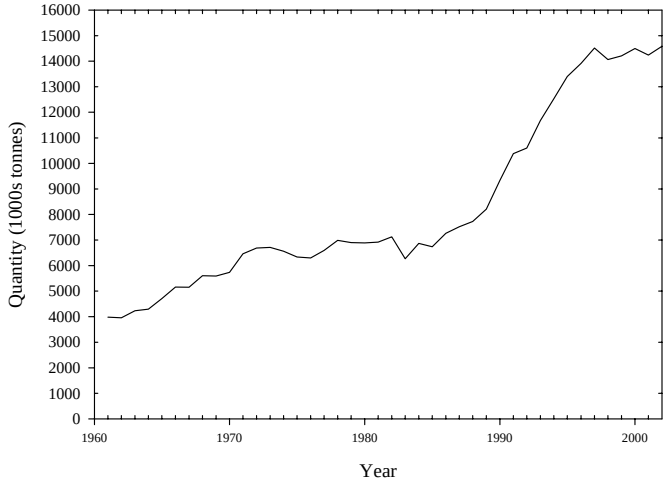
2.1 Bananas

2.1.1 Production and exports

Bananas are grown throughout the tropical and subtropical regions of the world. Most banana production (98 percent) is carried out in developing countries (see Appendix 1). Some of the largest banana-producing countries such as India, Brazil, China and Indonesia scarcely export as their production is almost entirely for domestic consumption. In other countries, such as Ecuador, Colombia, Costa Rica and the Windward Islands, bananas are primarily an export crop. In terms of volume, bananas are the most-traded fruit whilst they rank second after citrus fruit in terms of value. Around 12 percent of average annual world production (64.5 million tonnes) entered into world trade in 1997-2002 (see Figure 1), of which the five largest exporters – Ecuador, the Philippines, Costa Rica, Colombia and Guatemala – exported 81 percent.

Figure 1

World Exports of Bananas 1961-2002

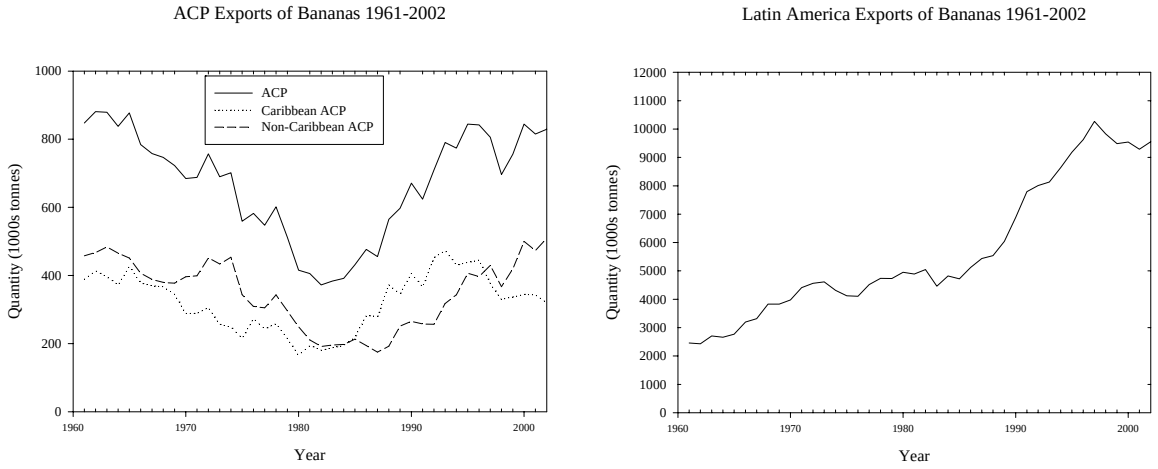


Source: FAOSTAT (2004).

There is significant fluctuation in exports from one year to the next, especially at individual country level (see Appendix 4) but world exports rose by 38 percent in volume between 1992 and 2002. Within this, ACP exports increased by 17 percent and Caribbean ACP exports fell in volume by 29 percent. Latin American exports rose by 19 percent (see Figure 2). Since 1993 (with the introduction of the common organisation of the market in bananas – see Section 3.1) Côte d'Ivoire and Cameroon (the two main African

banana suppliers) have increased their exports to the EU by over 100 percent (Borrell and Bauer, 2004), displacing Caribbean ACP suppliers.

Figure 2



Source: FAOSTAT (2004).

Bananas are a major source of income and export earnings to many developing countries in Latin America and the Caribbean (see Table 3). The share of bananas in total merchandise exports (during the 5 year period 1997-2002) from Caribbean ACP countries was especially high: 42 percent for St. Lucia; 24 percent for Dominica; 18 percent for St. Vincent and Grenadines; 10 percent for Belize; 4 percent for Suriname; and, 2 percent for Jamaica (it is negligible for the Dominican Republic and Grenada where textiles and spices are the major exports, respectively). The share of bananas in total exports is also important for a number of African ACP banana-producing countries: 3 percent for Cameroon; and, 2 percent for Côte d'Ivoire. Together, ACP countries accounted for 6.3 percent of world banana exports in 2002.

Table 3: The importance of Latin American and ACP countries' banana exports 1997-2002

Country	Average Annual Banana Exports ($000)	Average Annual Banana Exports to EU-25 ($000)	Average Annual Total Merchandise Exports ($000)	Banana Exports/Total Merchandise Exports	Banana Exports to EU/Total Merchandise Exports
St. Lucia	26,196	21,755	62,437	42%	35%
Dominica	13,023	11,542	54,210	24%	21%
Panama	146,790	125,460	736,318	20%	17%
Ecuador	981,744	382,630	5,154,765	19%	7%
St. Vincent/Grenadines	17,390	16,529	98,075	18%	17%
Belize	25,494	18,447	259,323	10%	7%
Costa Rica	574,180	390,155	6,279,447	9%	6%
Guatemala	174,619	15,723	4,033,993	4%	0%
Suriname	21,457	19,243	539,967	4%	4%
Colombia	444,239	321,651	11,902,983	4%	3%
Honduras	117,337	51,080	3,257,137	4%	2%
Cameroon	45,119	45,119	1,770,163	3%	3%
Jamaica	29,202	22,894	1,339,323	2%	2%
Nicaragua	12,833	8,103	669,337	2%	1%
Côte d'Ivoire	71,168	68,584	4,267,680	2%	2%
Philippines	262,035	219	32,620,017	1%	0%
Dominican Republic	58,214	36,770	5,086,552	1%	1%
Grenada	133	125	56,158	0%	0%
Venezuela	15,357	4,417	25,703,967	0%	0%
Mexico	38,156	2,161	141,662,833	0%	0%

Source: FAOSTAT (2004), IMF (2004a) and UN (2004).

2.1.2 Prices

World prices for bananas have been unstable (see Figure 3) reflecting changes in the competitive dynamics of multinational companies and banana-producing countries.

Figure 3

World Banana Prices 1975-2003 ($ constant 1990)

Source: IMF (2004b).

2.1.3 Consumption and imports

More than half of all bananas produced are consumed in the main banana-producing countries. Only two of the top ten banana-consuming countries are not major banana producers: the EU-25 and the US (see Table 4). These two areas consume 13 percent of the bananas produced globally.

Appendix 6 illustrates average annual world imports of bananas for 1997-2002. The largest banana importers are the EU-25 (accounting for 38 percent of world banana imports)[1], the US (29 percent) and Japan (7 percent). US imports in volume terms rose by 11 percent between 1992 and 2002 whereas Japanese and EU-25 imports each grew by 20 percent (see Appendix 8). The global market for bananas is characterised by regional market segmentation (see Appendix 10). Nearly all US imports of bananas (more than 99 percent) originate from Latin America; the majority of Japanese imports (82 percent) are from the Philippines; and, EU imports originate from Latin American (80 percent) and ACP sources (19 percent including Dominican Republic). Banana exports from ACP countries go almost exclusively to the EU.

[1] The EU-15 accounted for an annual average of 34 percent of world banana imports over the period.

Table 4: Main banana consuming countries, 2001

Country	Consumption (tonnes)	% of world
India	13,151,900	24
China	5,321,391	10
Brazil	5,145,597	9
EU-25 (EU-15)	3,697,606 (3,225,382)	7 (6)
Indonesia	3,322,829	6
US	3,236,768	6
Philippines	2,172,361	4
Mexico	1,660,498	3
Thailand	1,397,482	3
Vietnam	1,008,750	2
World	**54,831,181**	**100**

Source: FAOSTAT (2004).

A variety of trade regimes are employed by banana-importing countries. With the exception of the EU, all countries apply an *ad valorem* tariff on banana imports. Appendix 12 shows banana import tariffs. The average world tariff on bananas is 23.8 percent. Tariffs range from 134 percent (for Taiwan) to 0 percent (for 17 countries including the US, Canada, Australia and New Zealand). Japan imposes a seasonal tariff of 22.5 percent on bananas. The average tariff for the ACP group of countries is 30 percent. Only one ACP country (Sudan) imposes a zero tariff on banana imports. Nigeria imposes the highest tariff (100 percent) within the ACP group.

2.1.4 EU imports

The EU produces almost 20 percent of its total banana consumption in the Canary Islands (Spain); in the French Overseas Departments of Martinique and Guadeloupe; in Madeira and the Azores (Portugal); and, very small quantities in Crete (Greece). The rest is imported from the ACP countries and from Latin America.

Appendix 14 illustrates the source of EU imports between 1996 and 2002. Within the ACP group of main banana exporters, EU imports have risen in value terms from Cameroon (up 44 percent), the Dominican Republic (98 percent) and Côte d'Ivoire (31 percent). However, within the same group, EU banana imports in value terms from Belize (down 13 percent), Dominica (-42 percent), Jamaica (-43 percent), St. Lucia (-43 percent) and St. Vincent (-9 percent) have fallen. Suriname exports to the EU fell by 77 percent over the period: production ceasing altogether in April of 2002 due to the bankruptcy of Surland, the Government-operated banana production company. Exports from Grenada, where bananas are not the major crop, fell by 65 percent in value terms between 1996 and 2002. In 2004, the entire crop production was devastated by Hurricane Ivan.

For supplier countries and territories, for the most part highly dependent on their 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 ACP and European producers to survive.

2.1.5 Production costs

Production costs vary considerably between and within banana-producing countries. Data on the cost of production of bananas are not readily available and comparisons between countries is difficult due to the lack of a consistent methodology for reporting production costs. Despite these limitations, existing analysis suggests that Caribbean ACP producers are at a cost disadvantage, with per unit production costs in St. Vincent being almost three times as high as those in Ecuador. Given that bananas are highly perishable - the timing of harvests needs to be coordinated with the availability of ships - the most important of these cost factors facing banana producers is the transportation of bananas to retail markets.

Production, particularly in the Windward Islands, tends to be on small farms located on hilly land. The crop is largely rain-fed, since irrigation for small farms would be expensive and impractical, which causes large variations in crop yields. Shipping costs in the Caribbean are also high because vessels have to load at several ports and because the variable export volumes increase unit shipping costs (shipping 'air' is expensive in times of poor harvest). Banana production in the Caribbean is in stark contrast to that in Latin America where the large, flat plantations are operated on an industrial basis often with extensive mechanisation and irrigation. In addition, the depth and mineral content of soil in Latin America is better suited to banana production providing yields per hectare of more than double that in the Caribbean. Most importantly, large plantations are situated next to ports dedicated to the export of bananas. Together, these factors afford Latin America substantial economies of scale in the production of bananas (Read, 1994; IMF, 2002).

Wages of banana workers in the Caribbean are also significantly higher than those in Latin America. The minimum wage paid to banana workers is approximately three times higher than the wage paid to banana workers in Latin America (IMF, 2000). The daily agricultural wage in St. Lucia is between EC$25 and EC$40. In St. Vincent and the Grenadines the wage rate for agriculture is about EC$20 per day (Anderson *et al.*, 2003).

In addition to their costs, there is concern about the quality of Windward Island banana exports. A high proportion of banana exports from the Windward Islands are failing to meet specifications set by supermarkets in the EU who are increasingly demanding that traceability requirements and minimum environmental and labour standards are met (NERA/OPM, 2004).

2.2 Sugar

Natural calorific sweeteners take many forms and can be extracted from sugar beet, sugar cane and corn. Sugar beet is an annual root crop grown in temperate climates while sugar cane is a tall perennial grass grown in the tropics, often with a five year cropping cycle. Sugar beet is generally grown with other crops, whereas sugar cane is a monoculture. While cane sugar is traded internationally both in raw (milled) and refined (white) forms, most sugar beet is traded as white sugar (Mitchell, 2004). Common sugar has a number of substitutes. Starch-based sweeteners (often used in soft drinks) can be produced from starch in corn (US), wheat (EU) or potatoes (Japan) and low calorie artificial sweeteners such as saccharin and aspartame have been developed although demand has been limited due to their poor baking properties. Most notably, the development of new sweeteners (often derived from sugar) which can be heated to high temperatures such as sucralose - for which Tate and Lyle is the sole license holder - have begun to provide intense industry competition since 2000.

2.2.1 Sugar production

World sugar production averaged 133.5 million tonnes during 1997-2002. The EU, Brazil and India are the largest producers, respectively, accounting for 43 percent of world production during the period (see Table 5 and Appendix 2). The ACP countries produced an average of 6.2 million tonnes per year (4.7 percent of world output) during 1997-2002, of which the ACP Sugar Protocol countries were responsible for 4.2 million tonnes.

Of total world sugar production, over 70 percent is cane sugar and the remainder is beet. Brazil and India are the largest producers of cane sugar (it being the only sugar they produce), accounting for 54 percent of total cane sugar production during 1999-2001. The EU is the largest producer of beet sugar accounting for just under half of world beet sugar output (Milner *et al.*, 2003).

Table 5: Sugar production, 1997-2002 average

Producers	Production (millions tonnes)			% of world
World	**133.5**			**100%**
EU-25 (EU-15)	20.4 (16.9)			15.3% (12.7%)
Brazil	19.6			14.7%
India	18.0			13.5%
China	9.2			6.9%
US	7.6			5.7%
Thailand	5.5			4.1%
Mexico	5.1			3.8%
Australia	5.1			3.8%
Cuba	3.8			2.8%
ACP	6.2			4.7%
ACP Sugar Protocol	4.2			3.1%
Zimbabwe	0.59	Uganda	0.14	
Mauritius	0.56	Tanzania	0.12	
Swaziland	0.52	Belize	0.12	
Kenya	0.47	Trinidad & Tobago	0.1	
Fiji	0.32	Madagascar	0.07	
Guyana	0.29	Congo	0.06	
Malawi	0.21	Barbados	0.05	
Zambia	0.2	St. Kitts	0.02	
Jamaica	0.2	Suriname	0.01	
Côte d'Ivoire	0.15			

Source: FAOSTAT (2004).

2.2.2 Sugar exports

During 1997-2002 an annual average volume of 38.5 million tonnes of sugar was exported. Brazil is the largest exporter of sugar accounting for about one quarter of world exports followed by the EU and Australia (see Table 6). Relative to production, more beet sugar than cane sugar is sold on world markets. Cane sugar accounts for 56 percent of total sugar exports, while exports of beet sugar account for the remaining 44 percent (Milner *et al.*, 2003). This has implications for the distribution of export earnings in the world market.

At the global level, most sugar production is consumed locally in some of the largest producing countries (e.g. India and China) and, as such, only 29 percent of world sugar production enters into world trade. However, in a number of ACP Sugar Protocol countries most sugar production is for export (see Appendix 2).

Table 6: Sugar exports, 1997-2002 average

Producers	Exports (millions tonnes)			% of world
World	**38.5**			**100%**
Brazil	9.6			25%
EU-25 (EU-15)	7.9 (7.3)			21% (19%)
Australia	4.0			10%
Thailand	3.5			9%
Cuba	3.1			8%
South Africa	1.2			3%
Guatemala	1.2			3%
Colombia	1.0			3%
India	0.6			2%
ACP	2.9			8%
ACP Sugar Protocol	2.4			6%
Mauritius	0.55	Barbados	0.05	
Swaziland	0.44	Côte d'Ivoire	0.04	
Fiji	0.29	Congo	0.03	
Guyana	0.27	Tanzania	0.02	
Zimbabwe	0.19	St. Kitts	0.02	
Jamaica	0.16	Kenya	0.01	
Belize	0.11	Uganda	0	
Zambia	0.08	Madagascar	0	
Malawi	0.06	Suriname	0	
Trinidad & Tobago	0.06			

Source: FAOSTAT (2004).

Trade in sugar between the ACP sugar-producing countries and the EU is governed by two principal arrangements. First, the Sugar Protocol is a binding commitment, of indefinite duration, under which the EU has undertaken to "purchase and import, at guaranteed prices, specific quantities of cane sugar, raw or white, which originate in the ACP States and which these States undertake to deliver it." Second, the Special Preferential Sugar (SPS) Arrangement is a non-binding agreement under which an additional amount of sugar is supplied.

The quantity of sugar which the EU imports from the ACP under the Sugar Protocol is fixed at 1,294,700 tonnes per annum and is allocated according to the quantities illustrated in Table 7. The amount of sugar supplied under the SPS depends on an annual forecast of the surplus needs of EU sugar refiners and is, therefore, variable but has averaged 300,000 tonnes over the past few years.

Table 7: EU sugar quotas to ACP countries and India under the Sugar Protocol

Country	Tariff quota (tonnes, white sugar equivalent)
Barbados	50,312
Belize	40,349
Congo	10,186
Côte d'Ivoire	10,186
Fiji	165,348
Guyana	159,410
India	10,000
Jamaica	118,696
Kenya	0
Madagascar	10,760
Malawi	20,824
Mauritius	491,031
St. Kitts & Nevis	15,591
Suriname	0
Swaziland	117,845
Tanzania	10,186
Trinidad & Tobago	43,751
Uganda	0
Zambia	0
Zimbabwe	30,225
Total	*1,304,700*

Source: European Commission (2004c).

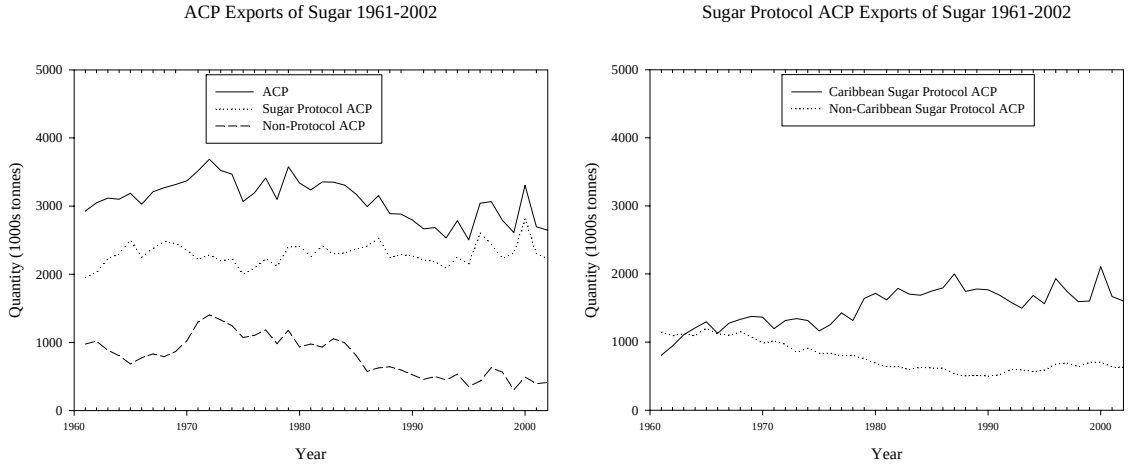
Duty free access for sugar imports from Least Developed Countries (LDCs) under the EU's Everything But Arms Initiative (see Appendix 3) commenced from a base level of 74,185 tonnes in 2001/02 and will increase by 15 percent each year until 2009, when all quota restrictions will be eliminated. The transitional sugar quotas are illustrated in Table 8.

Table 8: Transitional sugar quotas for LDCs under EBA

Year	Tariff quota (tonnes, white sugar equivalent)
2001/02	74,185
2002/03	85,313
2003/04	98,110
2004/05	112,827
2005/06	129,751
2006/07	149,213
2007/08	171,595
2008/09	197,335

World sugar exports rose by 40 percent in volume between 1992 and 2002. Within this, Sugar Protocol ACP exports increased in volume by 2 percent and non-Protocol ACP exports fell by 17 percent. Exports from Caribbean signatories of the Sugar Protocol rose by 5 percent and exports from non-Caribbean signatories increased by 1 percent (see Figure 4).

Figure 4



Source: FAOSTAT (2004).

Some Sugar Protocol countries (e.g. Guyana, Zambia, Zimbabwe, Côte d'Ivoire) have recorded significant export growth rates while a number of non-Protocol Caribbean ACP countries (e.g. Dominican Republic, Haiti) have witnessed dramatic declines (see Appendix 5).

Sugar exports (especially to the EU) are an important source of foreign exchange earnings for a number of developing countries (see Table 9). The share of sugar exports in total merchandise exports (during the 5 year period 1997-2002) from a number of Sugar Protocol countries was especially high e.g. 21 percent for Guyana. The share of sugar in total exports is also important for a number of non-Protocol ACP and non-Protocol non-ACP countries e.g. 38 percent for Cuba.

Table 9: The importance of sugar exports 1997-2002

Type of producer	Country	Average Annual Sugar Exports ($000)	Average Annual Sugar Exports to EU ($000)	Average Annual Total Merchandise Exports ($000)	Sugar Exports/Total Merchandise Exports	Sugar Exports to EU/Total Merchandise Exports
Non-Protocol non-ACP	Cuba	587,883	25,727	1,540,008	38%	2%
Protocol ACP	Guyana	127,903	96,294	602,655	21%	16%
Protocol ACP	St. Kitts and Nevis	10,388	7,857	49,675	21%	16%
Protocol ACP	Fiji	122,452	77,708	639,447	19%	12%
Protocol ACP	Mauritius	303,942	295,652	1,595,738	19%	19%
Protocol ACP	Belize	38,926	20,146	259,323	15%	8%
Protocol ACP	Barbados	26,262	26,262	262,257	10%	10%
Protocol ACP	Jamaica	86,215	79,787	1,339,323	6%	6%
Protocol ACP	Malawi	29,619	24,674	477,132	6%	5%
Non-Protocol non-ACP	Guatemala	232,962	1,281	4,033,855	6%	0%
Non-Protocol non-ACP	Nicaragua	35,224	2,299	669,337	5%	0%
Non-Protocol non-ACP	El Salvador	57,644	933	1,546,102	4%	0%
Non-Protocol non-ACP	Moldova	20,931	293	608,198	3%	0%
Protocol ACP	Zambia	27,551	4,219	825,933	3%	1%
Non-Protocol non-ACP	Brazil	1,865,843	22,824	56,187,983	3%	0%
Protocol ACP	Zimbabwe	66,364	19,150	2,291,477	3%	1%
Non-Protocol ACP	Sudan	34,056	3,503	1,186,090	3%	0%
Non-Protocol non-ACP	Panama	19,615	11	736,318	3%	0%
Non-Protocol ACP	Mozambique	10,917	3,235	414,810	3%	1%
Non-Protocol ACP	Dominican Republic	108,994	14	5,086,552	2%	0%
Non-Protocol ACP	Burundi	1,110	0	53,598	2%	0%
Non-Protocol non-ACP	Serbia and Montenegro	22,307	n.a.	1,183,063	2%	n.a.
Non-Protocol non-ACP	Colombia	221,571	593	11,902,983	2%	0%
Protocol ACP	Tanzania	11,912	7,798	714,543	2%	1%
Non-Protocol non-ACP	Australia	970,962	1,490	61,113,117	2%	0%

Source: FAOSTAT (2004), IMF (2004a) and UN (2004).

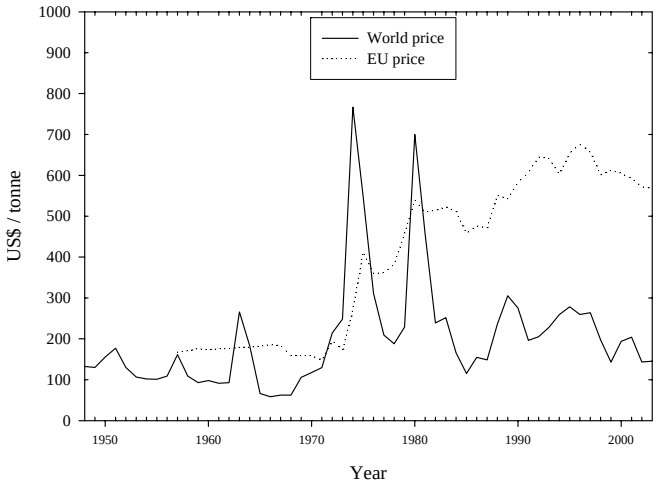
2.2.3 Prices

The world price for sugar has been unstable and, in recent years, there has been a downward pressure on it. Between 1960-1980, the world sugar price averaged around US$226/tonne (at constant 1990 prices). In 1974, it averaged US$767/tonne for the year; between 1984 and 1987 the average price of sugar never rose above US$166/tonne. In 1991 it was just US$196/tonne and in 2003 it averaged US$145/tonne. This is, however, a residual rather than a true world price, as most sugar (about 80 percent of total) is traded under special contract involving preferential pricing.

EU sugar prices have typically been more than three times the world price (see Figure 5). Arrangements to guarantee higher prices for domestic sugar producers in the EU (and also in the US) have allowed high-cost production to be sustained leading to a supply of sugar generally higher than it would otherwise be. In addition, the global supply of sugar is able to expand much more quickly in response to a price increase than it is able to contract when prices fall because of the high capital investment in specialised equipment in the sector and because of sugar cane's perennial crop cycle (Hagelberg and Hannah, 1994).

Figure 5

World and EU Sugar Prices 1948-2003 ($ constant 1990)



Source: IMF (2004b).

2.2.4 Consumption and imports

Currently, about two-thirds of world sugar consumption occurs in developing countries, compared to one-third in 1970 (Mitchell, 2004). India is the largest consumer of sugar accounting for about 17 percent of world consumption, followed by the EU-25 (11 percent), China (9 percent) and Brazil (6 percent) – see Table 10.

Table 10: Main sugar consuming countries, 2001

Country	Consumption (tonnes)	% of world
India	18,868,962	17
EU-25 (EU-15)	12,595,893 (8,790,664)	11 (8)
China	10,144,225	9
Brazil	7,339,871	6
US	7,025,152	6
Russian Federation	6,640,177	6
Mexico	4,608,933	4
Pakistan	3,214,046	3
Indonesia	2,876,441	3
Japan	2,272,911	2
World	**113,869,339**	**100**

Source: FAOSTAT (2004).

An annual average of 35.1 million tonnes of sugar was imported during 1997-2002 (see Appendix 7). Approximately one-half of world sugar imports are by developing countries compared to less than one quarter in 1970 (Mitchell, 2004). China, India, Vietnam, Thailand, and other Southeast Asian countries have been major growth markets for the soft drinks industry. In the developed countries, consumption has remained relatively stable reflecting slow population growth and generally low income elasticities of demand. In addition, competition from non-calorific sweeteners and decreasing dietary intake of sugar for health reasons are also reducing per capita demand. The largest sugar importers are the EU-25 (accounting for 14 percent of world imports),[2] Russia (13 percent), the US (5 percent) and Japan (4 percent) - see Appendix 9. There are regional differences among the source of sugar imports. Most US and Russian imports of sugar originate from Latin America and the majority of Japanese imports are from Australia and Thailand (see Appendix 11). Virtually all EU imports originate from the ACP, the Balkans and India. About three-quarters of sugar exports from ACP countries go to the EU.

Over 80 percent of world 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 (Mitchell, 2004).

[2] Includes intra-EU trade in sugar. Extra-EU imports are 2.15 million tonnes (6.1 percent of world imports), mostly from the Sugar Protocol ACP countries.

Appendix 13 shows sugar import tariffs. The average world tariff on sugar is 27.3 percent. Tariffs range from 357 percent (for Thailand) to 0 percent (for 33 countries including Canada, Australia and New Zealand). The average tariff imposed by the Sugar Protocol countries is 19 percent. Only one Sugar Protocol country (Madagascar) imposes a zero tariff on sugar imports.

2.2.5 Production costs

Sugar beet versus sugar cane

The costs of producing cane sugar and beet sugar differ. The sugar beet harvesting and manufacturing seasons are limited to around three months whereas the sugar cane harvesting and manufacturing seasons often last for at least six months. Longer seasons for production of cane sugar mean that capital costs can be spread over a greater volume of production. Recent estimates (see Table 11) suggest that the average production cost for refined beet sugar is almost twice that for low-cost producers of refined cane sugar. Based on this comparison beet sugar is not competitive with cane sugar. However, the wide margin between refined sugar from beets and that from cane is partly a reflection of the protection granted to beet producers in the EU and the US which encourages production in marginal, high cost areas. Production costs for starch-based sweeteners are comparable to those of refined sugar made from cane.

Table 11: Average costs of producing sugar

	1994/95	**1995/96**	**1996/97**	**1997/98**	**1998/99**
			US cents per pound (f.o.b.)		
Raw cane sugar					
Low cost producers /1	7.43	8.1	8.18	7.78	7.58
Major exporters /2	10.37	10.6	10.72	10.52	9.73
Cane sugar, refined					
Low cost producers /1	11.02	11.75	11.84	11.41	11.19
Major exporters /2	14.23	14.48	14.61	14.38	13.53
Beet sugar, refined					
Low cost producers /3	21.31	23.16	23.09	21.21	22.67
Major exporters /4	25.47	26.87	25.90	23.56	24.75
Starch-based sweeteners					
Major producers /5	13.45	16.78	13.57	12.86	11.76

1/ Average of: Australia, Brazil (centre/South), Guatemala, Zambia and Zimbabwe

2/ Average of: Australia, Brazil, Colombia, Cuba, Guatemala, South Africa and Thailand

3/ Average of: Belgium, Canada, Chile, France, Turkey, UK and US

4/ Average of: Belgium, France, Germany and Turkey

5/ Average of: Argentina, Belgium, Canada, Egypt, Finland, France, Germany, Hungary, Italy, Japan, Mexico, Netherlands, Slovakia, South Korea, Spain, Taiwan, Turkey, UK and US.

Source: Mitchell (2004).

Caribbean ACP production costs

Production costs of cane sugar in the Sugar Protocol ACP countries are in the range of 12-35 US cents per pound. In the Commonwealth Caribbean, Belize has the lowest costs of production overall (about 12-13 US cents per pound) followed by Guyana (within a range of 17-22 US cents per pound) and Jamaica (18-33 US cents per pound). St. Kitts, Barbados and Trinidad and Tobago have production costs approaching US 35 cents per pound reflecting their higher labour costs (Hewitt, 2000).

3. The EU's Banana and Sugar Regimes

3.1 The common organisation of the market in bananas

Since 1993 the EU Banana Regime, or the common organisation of the market in bananas (COMB), has been one of specific tariffs (a fixed charge per unit of imports) and tariff preferences (for ACP suppliers), and more importantly quotas. In order to manage the volume of imports entering the market, the EU has established import quotas for different groups of banana-producing countries. For volumes of bananas in excess of these, imports incur a prohibitive tariff. Though the basic structure of the regime survived up until the most recent proposals for a tariff-only system (to be introduced in 2006), its measures have been frequently changed (see Table 12 and Appendix 18) in response to challenges made to it 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. The aims of this decision are to maintain the EU market shares of its domestic producers (including overseas territories) and the ACP countries at their historic levels (20 percent each).

It is unlikely that such a high third-country tariff will bring an end to the banana dispute in the WTO given the concerns of suppliers from the dollar zone and the conditions of the Cotonou waiver (see below). Moreover, the use of a specific tariff remains an inefficient and non-transparent form of tariff protection since it is impossible to know precisely the actual protection it affords at any given time. Protection also fluctuates with exchange rate movements creating unpredictability for importers and retailers.

The move to a tariff-only regime must also be seen in the context of two other developments in EU trade policy. First, the WTO waiver authorising tariff preferences under Lomé expired at the same time as the Fourth Lomé Convention. Although imports continued to enter duty-free it was essential to legitimise these by obtaining a new waiver for the Cotonou Agreement. Requests were made by the EU and the ACP to the WTO on 29 February, 2000. Initially, Ecuador, Guatemala, Honduras and Panama blocked the request for a waiver arguing that it could not be considered in the absence of a final agreement on bananas[3] but it was finally agreed during the Doha Ministerial Conference, to secure EU approval for the launch of a new Round. As part of this compromise, the EU agreed that from 1 January 2006 (when the tariff-only regime is due to begin) the waiver will only apply to bananas if the new tariff is set at a level that will result in at least maintaining total market access for all WTO Member suppliers. If the EU decides to apply a tariff €230/tonne on third-country imports of bananas and suppliers from the dollar zone are able to prove that it results in a reduction of their market share then the loss of the waiver would be very serious for ACP banana exports.

[3] Even though the waiver would cover a much wider range of products.

Second, on 26 February 2001 the EU approved the Everything But Arms extension (EBA) to its Generalised System of Preferences. EBA provides for duty and quota free access to all (including agricultural) products originating in LDCs, except arms and ammunition. Only three most sensitive agricultural products were not liberalised immediately: bananas, rice and sugar. For bananas, EBA provides for full liberalisation between 1 January 2002 and 1 January 2006 by reducing the full (out-of-quota) tariff by 20 percent every year. Of the 49 LDCs eligible for EBA, 39 of them are ACP countries (see Appendix 3). Although banana exports from LDCs to the EU are currently negligible (see Appendix 10) it is not inconceivable that some of the largest LDC producers (Burundi and Bangladesh) could start exporting under more favourable preferences. As a result, there is potential for EU imports of bananas from non-LDC ACP countries to suffer preference erosion from LDC suppliers.

Table 12: The evolution of the EU's Banana Regime

	Initial Regime of 1993 **(1 July 1993)**	**1995 Reforms (Banana Framework Agreement)** **(1 January 1995)**	**1998 Reforms** **(1 January 1999)**	**Regime of 2001: Phase 1** **(1 July – 31 December 2001)**	**Regime of 2001: Phase 2** **(1 January 2002 – 1 January 2006)**	**Everything But Arms** **(1 January 2002 – 1 January 2006)**
Quantities imported from traditional ACP suppliers	Tariff quota of 857,700 tonnes free of customs duties, split on a country-specific basis.	Tariff quota of 857,700 tonnes free of customs duties, split on a country-specific basis.	Tariff quota of 857,700 tonnes free of customs duties, **no longer split** on a country-specific basis.	There were 3 quotas: Quota A – 2.2 million tonnes Quota B – 353.000 tonnes Quota C – 850,000 tonnes with Quotas A and B managed as one. All 3 quotas were open to imports originating in all countries. Imports under A and B were subject to a specific tariff of €75/tonne. Imports under C were subject to a specific tariff of €300/tonne. Out-of-quota imports were subject to a specific tariff of €680/tonne. A tariff preference of €300/tonne applied to imports originating in ACP countries both under and outside any of the three quotas effectively rendering them duty-free when imported within the quotas.	3 quotas but with a **transfer of 100,000 tonnes from C to B**: Quota A – 2.2 million tonnes Quota B – 453.000 tonnes Quota C – 750,000 tonnes with Quotas A and B managed as one. A and B were open to imports originating in all countries. **C is open to imports originating in ACP only.** Imports under A and B from non-ACP countries subject to a specific tariff of €75/tonne. ACP bananas are duty free. Imports under C are duty free. Out-of-quota imports subject to a specific tariff of €680/tonne. A tariff preference of €300/tonne applies to out-of-quota imports originating in ACP countries.	EBA extends duty and quota free access to all products originating in **LDCs** except arms and ammunition. Only three sensitive products were not liberalised immediately: fresh bananas, rice and sugar. For bananas, EBA provides for full liberalisation between 1 January 2002 and 1 January 2006 by reducing the **full** (out-of-quota) EU tariff by 20% every year.
Traditional ACP exports in excess of quota **Non-traditional ACP exports** **Third-country exports**	Tariff quota of 2.0 million tonnes. Within this, ACP exports were duty-free while third-country exports faced a specific tariff of 100 ECU/tonne (equivalent to 24% *ad valorem* at 1992 unit values)	Tariff quota of **2.2 million tonnes** divided into: - 49.4% for Costa Rica, Colombia, Nicaragua and Venezuela; - 50.6% less 90,000 tonnes for the other countries; - 90,000 tonnes for non-traditional ACP bananas specifically allocated, of which more than half was to the Dominican Republic. Within this, ACP exports were duty-free. Duties on non-ACP sources were **reduced** to 75 ECU/tonne. Introduction of an **autonomous** (EU discretionary) **quota** of 353,000 tonnes to allow for EU enlargement.	Tariff quota of 2.2 million tonnes divided into: - 26.17% for Ecuador; - 25.61% for Costa Rica; - 23.03% for Colombia; - 15.76% for Panama; - 9.43% for other. Within this, ACP exports were duty-free. Duties on non-ACP sources under the bound and autonomous quota were 75 **Euro**/tonne. Q**uota** of 353,000 tonnes to account for EU enlargement becomes permanent.			
Non-traditional ACP exports and third-country exports in excess of quota	Subject to specific tariffs of 750 ECU and 850 ECU/tonne (equivalent to 180% and 204% *ad valorem*, respectively at 1992 unit values)	Subject to specific tariffs of 750 ECU and 850 ECU/tonne, respectively.	Non-traditional ACP imports received a **tariff preference of 200 Euro/tonne**.			

3.2 The common organisation of the market in sugar

Sugar beet is grown in all EU Member States except Luxembourg, Estonia, Cyprus and Malta. Germany and France (including the French overseas territories) account for half of EU-25 sugar production, followed by Poland, Italy and the UK.

The common organisation of the market in sugar (COMS), or the Sugar Regime, was first introduced in 1968 (European Communities, 1967). Although it is part of the Common Agricultural Policy (which has undergone numerous reforms since its creation in 1958) the basic market support system for sugar has changed very little. The COMS provides for guaranteed prices to producers and growers 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 COMS is financed primarily by EU consumers (who pay higher than world prices) and levies on EU sugar production (paid to the EU budget) intended to cover the cost of exporting any surplus production over domestic consumption. In 2004, the EU budget for the sugar sector was €1.721 billion (European Commission, 2004b).[4]

The first change to the COMS occurred in 1975 following the UK's accession to EU in order to take account of its commitments under the Commonwealth Sugar Agreement to a number of former colonies[5] and at a time of world sugar shortage and brief Third World commodity power. The STABEX system was introduced simultaneously to provide resource flows to other commodity-dependent ACP countries which were not included under the Sugar Protocol (Hewitt, 1984). Annexed to the Lomé Convention, the Sugar Protocol provides for agreed quantities of preferential imports of cane sugar (raw or white) to the EU market at guaranteed prices[6] from 19 ACP countries.[7] Unlike most Articles of the Lomé Convention the Sugar Protocol is of indefinite duration and cannot be changed unilaterally but may be denounced by the EU with respect to each ACP state and by each ACP state with respect to the EU, subject to two years' notice. The terms of the initial Sugar Protocol were not amended when the standing agreement between the EU and the ACP was renewed at Cotonou in June 2000.

Under Article I of the Sugar Protocol, the EU guarantees that it will buy an annual agreed quantity of sugar from the ACP countries for an indefinite duration. The ACP also have their commitments under the Sugar Protocol (in Article I) which they have succeeded in keeping since 1975: to meet their annual delivery commitments of 1.3 million tonnes per

[4] Since 2000, the EU budget for the sugar sector has ranged between €1.437 billion (in 2003) and €2.101 billion (in 2000).

[5] The Commonwealth Sugar Agreement (CSA) governed the import of raw cane sugar into the UK for refining and marketing from developing Commonwealth sugar exporters and Australia. The EU-ACP and EU-India Protocols succeeded this.

[6] The guaranteed price is fixed each year by a Council decision approving the price for each country. It currently amounts to €523.70/tonne for raw sugar (the EU's intervention price) and €645.50/tonne for white sugar (the UK's derived intervention price) – Section 3.2.3.

[7] Barbados, Belize, Congo, Côte d'Ivoire, Fiji, Guyana, Jamaica, Kenya, Madagascar, Malawi, Mauritius, St. Kitts, Suriname, Swaziland, Tanzania, Trinidad and Tobago, Uganda, Zambia and Zimbabwe.

annum. The Sugar Protocol provides that the agreed quantities may not be reduced "without the consent of the individual states concerned" (Article III). However, the main way in which the Sugar Protocol can be amended is through changes in the guaranteed price "within the price range obtaining in the Community, taking into account all relevant economic factors" (Article V).

While it can be argued that, unlike the Banana Protocol, the Sugar Protocol is of indefinite duration, the COMS to which it is linked and on which it depends can be amended in a manner which affects the Sugar Protocol. Unilateral decisions taken by the EU either to comply with WTO commitments or, for example, to establish preferences for all LDCs under EBA are indicative of how changes in the COMS, taken independently of the Sugar Protocol, can have an impact on EU-ACP sugar trade.

3.2.1 Import controls

EU sugar imports are restricted through a combination of specific tariffs, safeguards, country-specific tariff quotas, rules of origin and country-specific suspensions from tariff preferences. Border protection is in the form of two types of import duty: a fixed specific tariff (€419/tonne)[8] and another resulting from the application of the special safeguard clause (on average €115/tonne).[9]

Within the WTO, the EU has a bound tariff-quota on 1.389 million tonnes of sugar which is allocated to the ACP Sugar Protocol signatories and India. The tariff-quota comprises of 1.304 million tonnes of refined sugar and a quota of 85,463 tonnes of raw cane sugar, and allows for reallocation of agreed quantities among countries if a supplier fails to fulfil its share.

The quantities of sugar covered by the tariff quotas for the ACP and India are the subject of the Sugar Protocol. Preferential sugar (SP) imported under this accounts for the majority of EU sugar imports which have remained much the same since UK accession to the EU (although the EU, now a net exporter, was initially a net importer of sugar). Agreed quantities are country-specific in terms of their allocation among exporting countries while individual refining Member States are allocated a Maximum Supply Need of raw sugar. Since guaranteed prices (at levels similar to those paid to EU producers) are paid for SP there is no price competition between preferential sugar imports and domestic production.

In addition to the Sugar Protocol, the EU also provides tariff preferences for sugar imports under three different systems: 1) agreed quantities at reduced duty rates for imports of raw cane sugar for refining under the 'Special Preferential System'; 2) duty

[8] €339/tonne for raw sugar to be used for refining.

[9] The additional duty varies depending on the world price of sugar, and applies once this falls below a 'trigger' price. The trigger price set during the Uruguay Round (€531/tonne) has led to the safeguard clause being applied permanently since 1995.

free access within quota limits for LDCs under EBA; and, 3) preferential access for designated Balkan countries and WTO market access commitments.

Special Preferential Sugar

In 1995, an additional annual import allocation was made of between 200,000 and 350,000 tonnes of sugar to primarily ACP countries. This sugar was called 'Special Preferential Sugar' (SPS) but unlike SP the allocation is not permanent (and not part of the Sugar Protocol). Annual allocations vary based on the maximum supply needs of EU refineries of which the share allocated to each ACP supplier is determined by a formula established in the ACP Council of Ministers. Imported quantities of SPS receive 85 percent of the guaranteed price for SP. The first phase of SPS lasted for six years and it was renewed in 2001 for the lifetime of the Sugar Regime (to 2006).

Everything But Arms

EBA allows duty free access to the EU sugar market for LDCs. EBA imports of sugar are limited by quotas, and the sugar imported under EBA is counted against the SPS agreed quantities. The EBA quota was initially 74,185 tonnes and will be increased by 15 percent a year (currently 100,000 tonnes) until full duty-free access for sugar is allowed for LDCs in 2009.

Preferential access for Balkan countries and WTO market access commitments

In 1995, the EU took over the WTO import commitments of its newly acceded members (Austria, Finland and Sweden). These included a tariff quota of 85,463 tonnes (facing a specific tariff of €98/tonne), mainly from Cuba (58,969 tonnes) and Brazil (23,930 tonnes). The EU also granted several countries in the Western Balkans[10] preferential access to its sugar market. Total imports from the Western Balkans peaked at 320,000 tonnes in 2002/03 and were one factor in the EU's decision to reduce its domestic production quotas in order to comply with WTO commitments. Subsequently, imports from the Balkans have declined following the suspension of the preference granted to Serbia and Montenegro (in 2003/04).

3.2.2 Restrictions on domestically-produced sugar

The COMS results in surpluses of sugar with annual EU-25 production (18-19 million tonnes) substantially in excess of consumption (17 million tonnes). In addition to sugar manufactured from domestically-harvested beet or cane, a further 1.6 million tonnes of sugar is manufactured from raw cane sugar imported from the Sugar Protocol ACP

[10] Albania, Bosnia-Herzegovina, Croatia, Former Yugoslav Republic of Macedonia, Serbia and Montenegro.

countries (European Commission, 2003a). In order to maintain the domestic price of sugar (and to avoid intervention buying) the COMS ensures that domestic production surplus to consumption is exported (with or without an export refund).

Production quotas specify the quantity of sugar eligible for guaranteed prices and export subsidies are used to limit the domestic supply of sugar produced from EU-harvested beet or cane. Quota sugar eligible for guaranteed prices or export subsidies are categorised as A and B quotas. Sugar surplus to quota, or C sugar, must (with a few exceptions) be exported without an export refund. Although negligible in the early years of the COMS, C sugar averaged 2.55 million tonnes between 1995 and 2003 (see Appendix 15).

The A quota beet (which comprises 82 percent of the total sugar quota) receives a higher minimum price and is nominally intended to meet domestic demand. Initially the B quota was the margin allowing producers to fill their A quota without risk of penalty. It was designed to allow the more competitive producers the possibility of expansion. However, the B quota has gradually developed into an established surplus for export, with all Member States being assigned both A and B quotas.

Sugar produced as A or B quota sugar or as C sugar is reclassifiable under the COMS. Sugar produced within the A and B quotas may be declassified in any one marketing year to C sugar for the purpose of the EU's WTO subsidy reduction commitments. Provision also exists for C sugar to be carried forward and reclassified as the next year's A quota.[11]

The COMS provides annual A and B quotas for each Member State, established for a five year period. For the current period (ending in 2006) the total annual sugar quota for the EU-25 is set at 17.4 million tonnes (see Table 13). Each Member State is responsible for assigning its national quota to its sugar processors and, in turn, each processor must then convert its quota into 'delivery rights' for each grower.

The COMS also established production quotas for products that compete with sugar:[12] isoglucose (507,680 tonnes) and inulin syrup (320,718 tonnes).

[11] The quantity of C sugar that can be reclassified is limited to 20 percent of the annual A quota set for the five year period.

[12] Some provisions for sugar, which include export subsidies but exclude the pricing arrangements, also apply to isoglucose and inulin syrup.

Table 13: EU-25 sugar production quotas (tonnes)

Country	Sugar			Isoglucose			Inulin syrup		
	A quota	B quota	Total	A quota	B quota	Total	A quota	B quota	Total
Austria	314,028.9	73,297.5	387,326.4	0.0	0.0	0.0	0.0	0.0	0.0
Belgium	674,905.5	144,906.1	819,811.6	56,150.6	15,441.0	71,591.6	174,218.6	41,028.2	215,246.8
Czech Republic	441,209.0	13,653.0	454,862.0	0.0	0.0	0.0	0.0	0.0	0.0
Denmark	325,000.0	95,745.5	420,745.5	0.0	0.0	0.0	0.0	0.0	0.0
Finland	132,806.3	13,280.4	146,086.7	10,792.0	1,079.7	11,871.7	0.0	0.0	0.0
France	2,536,487.4	752,259.5	3,288,746.9	15,747.1	4,098.6	19,845.7	19,847.1	4,674.2	24,521.3
France overseas departments	433,872.0	46,372.5	480,244.5	0.0	0.0	0.0	0.0	0.0	0.0
Germany	2,612,913.3	803,982.2	3,416,895.5	28,643.3	6,745.5	35,388.8	0.0	0.0	0.0
Greece	288,638.0	28,863.8	317,501.8	10,435.0	2,457.5	12,892.5	0.0	0.0	0.0
Hungary	400,454.0	1,230.0	401,684.0	127,627.0	10,000.0	137,627.0	0.0	0.0	0.0
Ireland	181,145.2	18,114.5	199,259.7	0.0	0.0	0.0	0.0	0.0	0.0
Italy	1,310,903.9	246,539.3	1,557,443.2	16,432.1	3,869.8	20,301.9	0.0	0.0	0.0
Latvia	66,400.0	105.0	66,505.0	0.0	0.0	0.0	0.0	0.0	0.0
Lithuania	103,010.0	0.0	103010.0	0.0	0.0	0.0	0.0	0.0	0.0
Netherlands	684,112.4	180,447.1	864,559.5	7,364.6	1,734.5	9,099.1	65,519.4	15,430.5	80,949.9
Poland	1,580,000.0	91,926.0	1,671,926.0	24,911.0	1,870.0	26,781.0	0.0	0.0	0.0
Portugal	63,380.2	6,338.0	69,718.2	8027.0	1,890.3	9,917.3	0.0	0.0	0.0
Azores	9,048.2	904.8	9,953.0	0.0	0.0	0.0	0.0	0.0	0.0
Slovakia	189,760.0	17,672.0	207,432.0	37,522.0	5,025.0	42,547.0	0.0	0.0	0.0
Slovenia	48,157.0	4,816.0	52,973.0	0.0	0.0	0.0	0.0	0.0	0.0
Spain	957,082.4	39,878.5	996,960.9	74,619.6	7,959.4	82,579.0	0.0	0.0	0.0
Sweden	334,784.2	33,478.0	368,262.2	0.0	0.0	0.0	0.0	0.0	0.0
UK	1,035,115.4	103,511.5	1,138,626.9	21,502.0	5,735.3	27,237.3	0.0	0.0	0.0
EU-25	**14,723,213.3**	**2,717,321.2**	**17,440,534.5**	**439,773.3**	**67,906.6**	**507,679.9**	**259,585.1**	**61,132.9**	**320,718.0**

Source: European Commission (2004c).

3.2.3 Domestic support

Within the limits of the A and B quotas, domestic support for sugar processors and growers - estimated at €5.8 billion - is provided in the form of minimum beet prices. Sugar processors pay a fixed minimum price for the quantities of beet required to produce quota sugar: €46.72/tonne for A-beet and €32.42/tonne for B-beet.[13] The minimum price does not apply to purchases of beet for C sugar production.

In addition to minimum beet prices for growers, the COMS also establishes a guaranteed minimum price for sugar processors and refiners in the form of an intervention price. If prices fall below this intervention price then the EU is obliged to purchase the surplus but due to import controls and the compulsory export of C sugar this has happened only once in the last 25 years: 15,000 tonnes withdrawn from the market in 1986 (European Commission, 2004c). Following two periods of increase (coinciding with two world sugar shortages) in the mid-1970s and at the beginning of the 1980s (see Appendix 16)

[13] The minimum beet price is set such that growers receive 58 percent of the intervention price for beet with 16 percent sugar content, assuming 13 percent extraction.

the current intervention price has been frozen since 1993/94 at more than three times the world price:[14] €631.90/tonne for white sugar and €523.70/tonne for raw sugar.

Each year the Commission also sets 'derived' intervention prices for white sugar from the EU's 'deficit areas' i.e. those areas where sugar production is lower than consumption. Originally, there were derived prices only for Italy but these were subsequently introduced for the UK and Ireland, Spain, Portugal and Greece (European Commission, 2004c).[15] Derived prices are €16-€23/tonne higher than the basic intervention price, depending on the Member States (see Table 14). The difference is calculated by estimating sugar transport costs between surplus and deficit countries. Beet producers receive a proportion of this, added to the minimum beet price, in the form of a 'regionalisation premium'.

Table 14: Derived intervention prices and regionalisation premiums, 2004/05

Member States	Derived intervention price (€/tonne)	Regionalisation premium (€/tonne)
UK and Ireland, Portugal, Finland	646.50	1.90
Spain	648.80	2.20
Greece, Italy	655.30	3.04

Source: European Commission (2004c).

The COMS also provides support to EU pure cane refineries in the form of 'refining aid' on imports of Protocol sugar to make adjustment for the different costs of their raw materials. Production refunds are also paid to the pharmaceutical and chemical industries to take account of the costs arising from the use of imported sugar from the world market. Finally, there are a number of special provisions for sugar production in the EU's outermost regions. For the French overseas territories 'disposal aid', averaging €74/tonne, is provided on 240,000 tonnes of cane sugar to offset transport costs between their plantations and the refineries located in Continental Europe. In the Azores support for 700 tonnes of sugar is paid to beet growers (€800/hectare) and to sugar factories (€270/tonne). Aid is also granted in Madeira for the processing of cane into sugar syrup (250 tonnes) and rum (2,500 litres).

3.2.4 Export subsidies

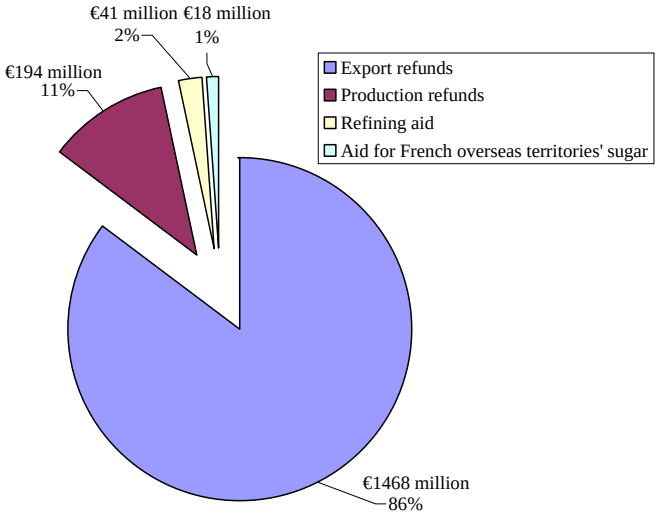
Export subsidies are intended to cover most of the difference between the (higher) domestic EU price and the world price for sugar, allowing surplus quota production to be exported from the EU. In 2003/04, the average export subsidy for EU white sugar was

[14] Although the intervention price has been constant in nominal terms since 1984/85 (Mitchell, 2004).
[15] Under the COMS the new Central and Eastern European Member States form a single, non-deficit area.

€511/tonne[16] which corresponded to a total budgetary expenditure of €1.468 billion (see Figure 6).

Levies are applied on the production of all domestic quota sugar to cover the cost of export subsidies.[17] Levies are collected by the Member States from sugar processors and paid to the EU budget after the deduction of a 25 percent collection charge. Payment of levies is divided between sugar processors (42 percent) and growers (58 percent).[18]

Figure 6: EU budgetary expenditure on sugar, 2003/04



Source: European Commission (2004b).

3.2.5 Pressures for reform of the COMS

There are a number of internal and external pressures that have made reform of the COMS inevitable.

WTO disciplines

The COMS came within the remit of the Uruguay Round Agreement on Agriculture. Under this, the EU had to fix and then lower its specific tariff on non-Protocol imports from 507 ECU/tonne (in 1995/96) to 419 ECU/tonne (by 2000/01). In addition, the EU has had to reduce the value and volume of its subsidised sugar exports although the

[16] The average export subsidy for EU white sugar was €443/tonne in 2001/02 and €485/tonne in 2002/03.
[17] The levy on A quota sugar is 2 percent (€12.60/tonne) and the levy on B quota sugar is 37.5 percent (€237/tonne). An additional levy can be imposed if the revenue generated is still insufficient: a flat-rate percentage of the payments made by each enterprise under the A and B quota levies, with no maximum being set so as to achieve the funds required. Since 1990, the additional levy has been applied, on average, every other year at a flat-rate of 18.5 percent (European Commission, 2004c).
[18] Refiners recover their share of the levy by deducting it from the minimum beet price.

impact of this has been limited by the ACP/India equivalent which has remained exempt. Only EU exports net of preferential imports have been affected by its export subsidy reduction commitments under the WTO which have had little effect since the EU was initially a net importer of sugar. Future WTO disciplines affecting agriculture, as outlined in the most recent July Framework Agreement, will continue to have an impact on the COMS by way of reducing tariffs (with perhaps a tariff cap) and domestic support and eliminating export subsidies.

The panel ruling in favour of Brazil, Australia and Thailand

On 4 August 2004, a WTO panel ruled in favour of Brazil, Australia and Thailand condemning EU export subsidies on sugar. The complainants had focused their case on showing the EU to be excessively subsidising sugar exports in violation of their WTO reduction commitments under the Uruguay Round Agreement on Agriculture. They successfully argued that 2.7 million tonnes of C sugar was being cross-subsidised by support on in-quota (A and B) sugar; and that imports (1.6 million tonnes) of raw sugar from the ACP (and India) refined in the EU and re-exported with the aid of subsidies were not excluded from the EU's WTO commitments.

If the EU is required to implement the panel decision this could reduce the guaranteed prices in the COMS. However, the EU has already decided to appeal and, failing this, implementation of any changes to comply with the ruling could be drawn out for several years. Moreover, the proposed reforms to the regime may allow the EU to argue that it has already acted to comply (as it did with the first GATT panel ruling for bananas). As with bananas this would only serve to postpone and not avoid reform because the proposed changes are unlikely to result in the COMS becoming WTO compliant.

Everything But Arms and Economic Partnership Agreements

EBA will allow unrestricted duty-free access to the EU market for sugar produced in LDCs by 2009. These imports are currently subject to a separate regime of quotas. EBA benefits Least Developed ACP countries with no previous allocation under the Sugar Protocol. It is likely to reduce imports from Sugar Protocol holders because it will not be possible to increase sugar imports from LDCs without reducing some combination of EU production, Sugar Protocol quotas or guaranteed prices.[19] This affects those ACP countries which are not LDCs, with Guyana being among the poorest within the set which includes Kenya, Ghana and Zimbabwe (Hewitt, 2001). In March 2004, the LDC Sugar Group issued a position paper proposing that the provisions for sugar under EBA be amended. It asked for delayed implementation of free access under EBA, combined with greater access in the short-term. It proposed to increase duty free access to the EU market for LDCs to 1.6 million tonnes (essentially unrestricted) by 2015/16 but the

[19] The European Commission (2000) estimates that EU sugar imports could increase by an additional 2.7 million tonnes although more recent studies have suggested that this has been overestimated. Cernat *et al.* (2004) model an increase of between 50,000 and 100,000 tonnes.

reduction in tariffs (originally scheduled to take place between 2006 and 2009) was to be deferred until 2016 to 2019.

A longer-term challenge to the COMS is the negotiation of free trade agreements between the ACP and the EU to replace non-reciprocal preferences under the Cotonou Agreement. If such Economic Partnership Agreements include sugar in the goods to be liberalised, this could extend duty free access to non-Protocol sugar-producing countries. If sugar is not included they are unlikely to comply with the WTO requirement to include 'substantially all trade'.

CAP reform

There are concerns over both the cost to EU consumers (mainly food processors) and the budgetary costs associated with the need to accommodate new Member States in Central Europe which are beet producers (especially Poland). On 14 July 2004, the Commission presented proposals for reform of the COMS to begin in 2005 and set for completion by 2008 (European Commission, 2004d). This was followed by an announcement at the Agriculture Council on 22 November stating that reform would be implemented at least a year later than originally planned: the Council of Ministers is now aiming for political agreement on the proposals before the Hong Kong WTO Ministerial meeting to be held in December 2005. The impact of the proposed reforms would reduce the level of intervention and support in the EU sugar market. The main elements are as follows: support prices will be reduced by a third over three years from €632/tonne to €421/tonne; A and B quotas will be merged into a single quota and will be cut by 2.8 million tonnes (16 percent) over four years from 17.4 million tonnes to 14.6 million tonnes; the merged production quota will become transferable between Member States; EU sugar producers will receive a decoupled payment equivalent to 60 percent of their losses; subsidised exports will be reduced from 2.4 million tonnes to 0.4 million tonnes; production refunds for use of sugar in the chemical and pharmaceutical industries will be abolished; and, guaranteed sugar export volumes under the Sugar Protocol will remain but will receive the lower intervention price.

4. The economic impacts in ACP countries arising from reform of the COMB and the COMS

Preference erosion can occur when the number of beneficiaries entitled to preferential trade treatment in a preference-giving country increases; when a preference-giving country lowers its MFN tariff without lowering preferential tariffs accordingly; or, in the case of the EU's banana and sugar markets, when a preference-giving country reduces or eliminates preferences.

For small Caribbean, Pacific and Indian Ocean countries, highly dependent on exports in heavily protected commodities such as sugar and bananas, the gains from preferences are large. Alexandraki and Lankes (2004) find that for Middle Income Countries sugar and banana preferences account for three-quarters of the value of preferences received by the largest beneficiaries (with average preference margins greater than 5 percent) in the EU, US, Japan and Canada (see Table 15).

Table 15: Contribution of major export products to preference margins

		% of margin accounted by preferences for:			
	Total preference margin 1/	**Sugar**	**Bananas**	**Textiles and clothing**	**Other products**
Middle-Income Countries 2/	**4.9**	**42**	**19**	**12**	**27**
Largest beneficiaries	**15.6**	**51**	**24**	**8**	**17**
Mauritius	39.9	84	0	13	3
St. Lucia	32.9	0	94	2	4
Belize	29.3	47	23	0	30
St. Kitts and Nevis	28.7	94	0	0	6
Guyana	24.2	95	0	1	4
Fiji	24.1	96	0	1	2
Dominica	15.9	0	97	0	3
Seychelles	12.2	0	0	0	100
Jamaica	9.7	67	8	7	18
St. Vincent and Grenadines	9.4	0	89	0	11
Albania	8.9	0	0	48	52
Swaziland	8.2	97	0	1	2
Serbia and Montenegro	7.6	28	7	10	56
Honduras	6.7	56	9	19	15
Tunisia	5.9	0	1	79	20
Côte d'Ivoire	5.7	8	51	2	38
Morocco	5.7	0	4	64	33
Dominican Republic	5.5	23	16	27	34

1/ As a percent of the trade-weighted average world market price of the country's exports
2/ Average for 76 Middle Income Countries, weighted by margin.

Source: Alexandraki and Lankes (2004).

4.1 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 and exports to those economies. Against most measures, the Caribbean ACP can be considered to be the most banana-dependent of the ACP countries. As such, the steep declines in their banana exports arising from successive changes to the Banana Regime have been particularly severe.

4.1.1 The impact of previous reform in the EU's banana market on production in the Caribbean ACP

As shown in Table 16, the value of banana exports from the Windward Islands has been decreasing steadily over the last decade. Windward Island exports increased until the early 1990s but following the introduction of the COMB exports declined by 58 percent in value terms between 1993 and 2002. Banana exports from Jamaica have shown a similar (but less severe) trend. In contrast, Belize, the Dominican Republic and Suriname witnessed an increase in banana exports during the 1980s and 1990s.[20]

Table 16: Value of banana exports from the Caribbean 1980-2002 (US$ millions)

Year	Belize	Jamaica	Suriname	Dominican Republic	Dominica	Grenada	St. Lucia	St. Vincent	Windward Islands
1980	3.5	10.5	5.9	1.3	3.0	4.1	10.5	6.5	24.2
1981	2.0	4.3	6.8	2.7	9.2	3.7	14.7	10.0	37.7
1982	2.1	4.7	7.4	1.1	10.0	3.4	15.6	9.1	38.1
1983	2.4	7.0	7.4	0.4	11.2	3.3	18.6	11.0	44.1
1984	3.1	1.6	9.0	0.1	11.1	2.9	23.8	11.8	49.6
1985	3.3	4.2	10.2	0.1	13.3	3.6	30.2	16.9	64.0
1986	4.6	9.2	12.3	0.1	24.9	3.9	55.4	19.4	103.5
1987	7.2	19.1	10.2	0.1	32.0	4.3	45.1	19.6	101.1
1988	8.6	15.7	11.3	0.1	38.4	5.8	68.7	31.9	144.7
1989	18.0	19.3	10.2	0.2	25.1	4.5	60.3	33.3	123.2
1990	16.0	38.2	10.3	2.0	30.7	4.3	73.9	44.5	153.4
1991	14.0	48.5	9.1	3.1	31.5	4.0	59.9	36.9	132.3
1992	18.0	39.7	9.6	8.4	30.5	2.9	71.2	41.5	146.1
1993	20.0	35.5	8.5	11.9	25.3	1.8	58.0	25.7	110.8
1994	24.5	46.1	10.8	16.6	21.0	2.1	46.8	16.7	86.6
1995	21.0	45.7	11.3	9.9	16.8	1.8	55.9	24.5	99.0
1996	28.7	43.6	17.6	12.0	18.2	0.6	52.8	20.5	92.1
1997	26.1	45.2	24.4	10.0	17.1	0.0	34.6	14.4	66.1
1998	24.7	36.0	17.0	13.0	15.0	0.0	32.4	20.9	68.3
1999	27.3	32.4	21.0	16.6	14.8	0.1	32.6	20.5	68.0
2000	31.9	21.2	24.9	19.8	13.5	0.2	21.8	18.3	53.9
2001	24.0	20.2	21.0	36.2	9.5	0.2	14.9	13.5	38.1
2002	19.0	20.2	0.5	46.3	8.1	0.2	21.0	16.7	46.1

Source: FAOSTAT (2004).

[20] Banana exports from Suriname declined sharply in 2002 as a result of the bankruptcy of the parastatal Surland. Banana exports from Suriname resumed in 2004 due to the launch of a new company (NERA/OPM, 2004).

St. Lucia, the largest banana exporter among the Windward Islands, has experienced a 64 percent reduction in the value of its banana exports since 1993, from US$58.0 million to US$21.0 million in 2002. St. Vincent and Dominica have witnessed reductions of 35 percent and 68 percent, respectively. The most dramatic decrease has been for Grenada which saw an 89 percent decrease from US$1.8 million to US$0.2 million over the same period.

Table 17 illustrates banana exports as a proportion of total export earnings from goods and services for the banana-producing Caribbean ACP countries. In 2002, the Windward Islands had the highest level of banana export dependence (5.3 percent). Export dependency is greatest for St. Lucia and St. Vincent where banana exports in 2002 accounted for 5.8 percent and 9.8 percent, respectively, of total exports of goods and services. In contrast, banana exports account for only 0.1 percent of total exports of goods and services in Grenada.

Table 17: Banana exports as a proportion of total goods and services exports 1980-2002 (percent)

Year	Belize	Jamaica	Suriname	Dominican Republic	Dominica	Grenada	St. Lucia	St. Vincent	Windward Islands
1980	3.2	0.8	1.0	0.1	23.3	10.4	11.8	19.7	13.8
1981	2.0	0.3	1.2	0.2	40.3	9.5	18.7	23.4	20.5
1982	2.5	0.4	1.4	0.1	33.5	8.9	18.9	18.1	18.9
1983	2.6	0.5	1.7	0.0	34.1	8.4	18.9	19.1	19.3
1984	2.4	0.1	2.1	0.0	34.7	7.0	22.9	16.5	19.9
1985	3.3	0.4	2.8	0.0	36.9	6.5	26.0	20.5	22.1
1986	3.6	0.7	3.8	0.0	41.6	5.0	33.2	20.7	26.1
1987	4.3	1.2	3.0	0.0	47.5	5.4	25.0	21.5	24.1
1988	4.4	0.9	3.0	0.0	48.8	6.7	28.7	25.5	27.3
1989	8.3	1.0	4.9	0.0	34.7	5.2	24.2	28.7	23.5
1990	6.2	1.7	6.2	0.1	33.9	4.5	25.6	34.1	25.4
1991	5.8	2.4	6.0	0.1	34.1	4.1	19.9	32.8	21.9
1992	6.4	1.8	8.3	0.4	30.6	2.9	22.0	30.0	22.1
1993	7.0	1.5	9.5	0.4	26.0	1.5	17.4	21.5	16.5
1994	8.5	1.8	7.8	0.5	19.8	1.7	13.8	14.8	12.7
1995	7.1	1.6	7.1	0.3	15.1	1.5	14.8	17.9	13.2
1996	9.3	1.5	8.7	0.3	15.0	0.5	15.0	13.8	12.2
1997	7.9	1.5	10.4	0.2	12.5	0.0	9.6	9.8	8.4
1998	7.4	1.2	5.9	0.3	9.9	0.0	8.4	13.3	8.0
1999	6.5	1.0	8.7	0.4	9.5	0.1	8.5	11.7	7.3
2000	7.1	0.6	14.3	0.4	9.4	0.1	5.4	10.3	5.6
2001	5.4	0.6	11.7	0.7	8.0	0.1	4.2	7.6	4.4
2002	4.3	0.7	0.5	0.8	5.9	0.1	5.8	9.8	5.3

Source: FAOSTAT (2004), World Bank (2004b) and IMF (2004a).

The production and export of bananas account for significant shares of Gross Domestic Product in a number of Caribbean ACP countries (see Figure 7). In terms of GDP, the Windward Islands and Belize have the highest dependence on bananas. The share for the four Windward Islands rose from 10.4 percent in 1980 to 21.7 percent in 1988, falling steadily to 4.4 percent in 2002. In 2002, the share of banana production in GDP in each of Dominica, St. Lucia and St. Vincent & Grenadines was 5-6 percent. The importance of bananas in GDP is lowest for Grenada, though there have been attempts to revive the industry in recent years.

The Windward Islands have experienced a steady decline in their share of banana production in GDP and exports. However, only some of this decline can be attributed to changes in the banana market since each of the four islands has been steadily diversifying its economy, based on an inflow of foreign investment and increased exports of services, particularly tourism (see Figure 7). Until June 2004, tourism in the Caribbean witnessed average growth rates of 9 percent per year. Following the hurricane damage in September, growth of 4-5 percent has been predicted for the second half of 2004 (Yee, 2004).

Receipts from tourism are particularly important for St. Lucia, contributing 41 percent to GDP. Tourism and small-scale manufacturing have benefited from a government focus on improving roads, communications, water supply, sewerage, and port facilities. Foreign investment has been attracted by the infrastructure improvements as well as by the educated and skilled work force and relatively stable political conditions. The government is also attempting to diversify production by encouraging the establishment of tree crops such as mangos and avocados. In addition, St. Lucia recently added small computer driven information technology and financial services as development objectives.

In Dominica, the eco-tourism industry has been actively promoted in its national development agenda in order to diversify away from banana production. The country is also diversifying its agricultural sector into new areas of production such as high quality fruits and vegetables for the regional market.

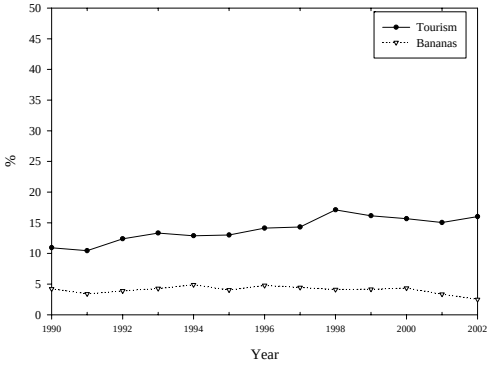
In Grenada, tourism has been the main growth sector since the 1980s, and continues to play a central role in the government's economic diversification strategy. Grenada also produces cocoa and spices (cloves, ginger, cinnamon, mace and nutmeg). Production of nutmeg, before the devastation caused by Hurricane Ivan in September 2004, accounted for a quarter of world output and was the largest source of foreign exchange in Grenada's agricultural sector, generating € 21,638 million in 2001 (Yee, 2004).

St. Vincent is trying to develop its tourism sector through the use of government diversification initiatives aimed at the declining banana sector. In addition, St. Vincent has become the main supplier of arrowroot flour to Canada and the US. Fisheries and manufacturing production have also expanded.

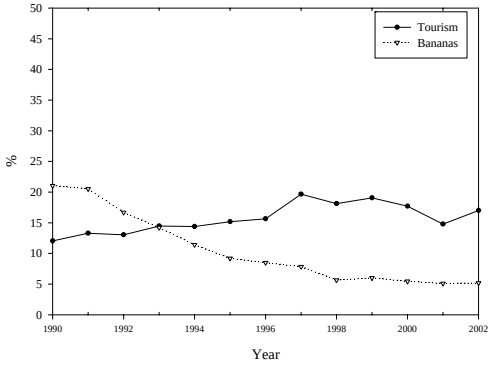
Figure 7: Bananas and tourism as a proportion of GDP 1990-2002

Source: FAOSTAT (2004), World Bank (2004b) and UNCTAD (2004).

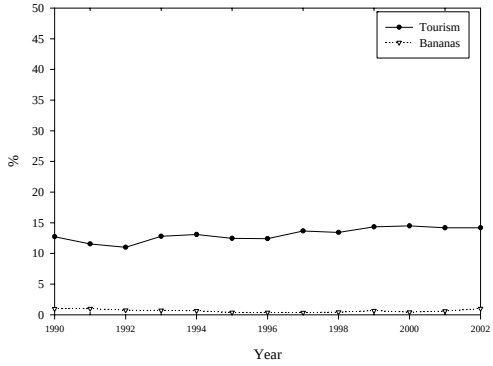
Belize



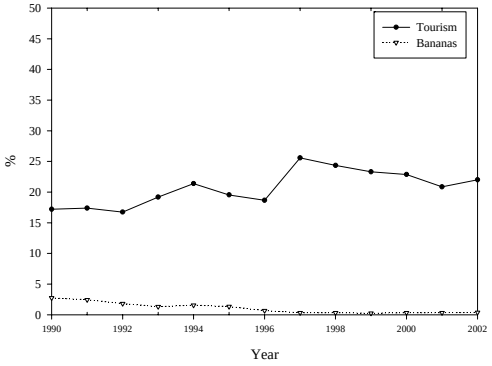
Dominica



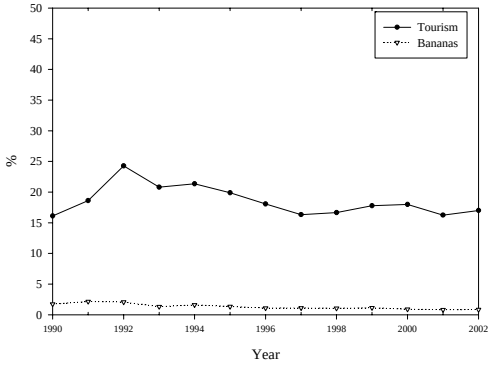
Dominican Republic



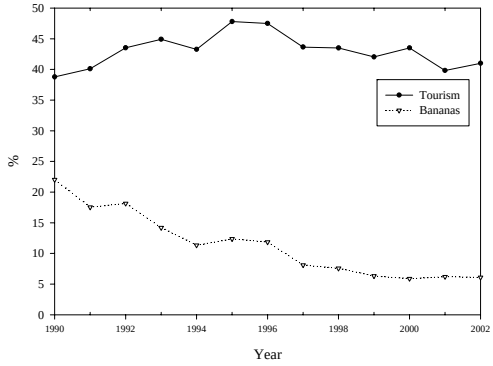
Grenada



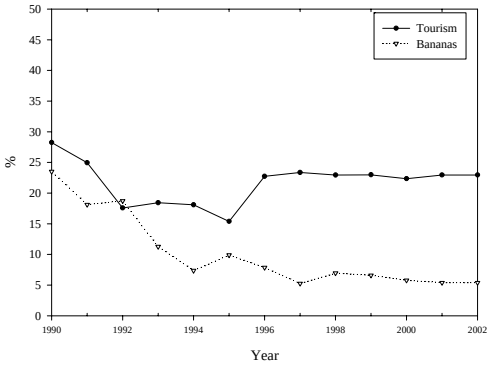
Jamaica



St Lucia



St Vincent & Grenadines



Suriname

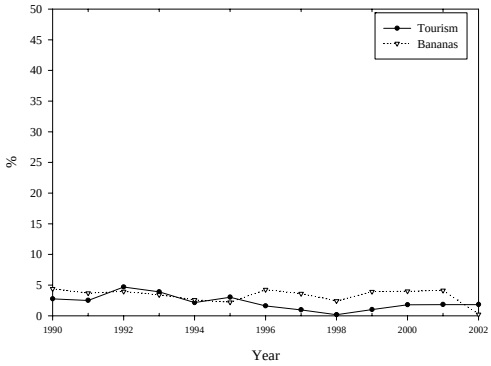


Table 18 shows that, with the exception of Suriname, tourism export growth has compensated for the decline in banana exports from the Caribbean, even in the highly banana-dependent Windward Islands. The shift in the structure of production reflects the comparative advantage of Caribbean countries that are land scarce, but have moderate levels of human capital and climatic advantages well-suited to tourism. Among the Windward Islands, the largest increases in receipts from tourism have occurred in St. Lucia, rising by 68 percent from 1990 to 2001, and in St. Vincent rising by 43 percent over the same period.

Growth in tourism exports has reduced dependence on banana exports and has helped to limit the economy-wide impact of preference erosion. In St. Lucia, for example, the number of active banana farmers fell by more than 50 percent between 1993 and 1997, while employment in the tourist industry increased by 27 percent (IMF, 1999).

However, for Dominica and Grenada the increases in tourism expenditures have been only modest. In Dominica the low growth experienced in the tourism sector over the past few years (it is mostly volcanic and has few beaches) has promoted efforts to revive banana production, such as the Banana Recovery Plan: a recent effort to secure niche markets, such as those for organic[21] and Fair Trade bananas.

Table 18: Caribbean exports of bananas and tourism 1990-2002, US$ millions

Country	Exports	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Belize	Bananas	16	14	18	20	25	21	29	26	25	27	32	24	19
	Tourism	44	45	60	69	71	77	89	88	108	111	121	121	122
Dominica	Bananas	31	32	31	25	21	17	18	17	15	15	14	10	8
	Tourism	20	24	25	29	31	34	37	48	47	51	48	39	41
Dominican Republic	Bananas	2	3	8	12	17	10	12	10	13	17	20	36	46
	Tourism	900	877	971	1246	1429	1568	1766	2099	2153	2483	2860	2798	2800
Grenada	Bananas	4	4	3	2	2	2	1	0	0	0	0	0	0
	Tourism	38	42	42	48	56	54	55	78	83	88	93	83	86
Jamaica	Bananas	38	48	40	35	46	46	44	45	36	32	21	20	20
	Tourism	740	764	858	942	973	1069	1092	1131	1197	1280	1333	1233	1236
St. Lucia	Bananas	127	110	123	120	106	124	82	66	64	60	63	67	55
	Tourism	154	173	208	221	224	268	269	253	278	279	297	258	261
St. Vincent & Grenadines	Bananas	45	37	42	26	17	24	20	14	21	21	18	14	17
	Tourism	56	53	41	44	44	41	64	69	73	76	75	80	84
Suriname	Bananas	10	9	10	8	11	11	18	24	17	21	25	21	1
	Tourism	11	11	19	17	13	21	14	9	2	9	16	14	14

Source: FAOSTAT (2004) and UNCTAD (2004).

Employment figures provide an indication of the social impact of the decline in the Caribbean banana industry. Bananas remain a major source of income and employment in

[21] The main suppliers for the organic banana market are the Dominican Republic, Mexico, Colombia, Honduras, Costa Rica and the Philippines.

the Windward Islands where the sector is by far the largest agricultural activity in Dominica, St. Lucia, and St. Vincent and the Grenadines. Employment engaged in banana production in Grenada is now relatively small compared to that involved in nutmeg and other agricultural exports. Table 19 shows the number of registered farmers in the Windward Islands has declined from around 24,100 in 1993 to 7,300 in 2001 – a fall from 6.7% to 2.0% of the working population (NERA/OPM, 2004).

Table 19: Number of Registered Farmers in the Windward Islands, 1993-2003

1000s	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**
Dominica	5.8	6.8	6.2	5.5	4.8	2.9	2.9	2.4	1.3	1.0	1.0
Grenada	0.9	0.9	0.5	0.2	-	0.1	0.1	0.1	0.1		
St. Lucia	9.7	8.0	7.4	6.7	4.8	4.5	5.2	4.8	3.8	2.0	2.0
St. Vincent	7.8	7.4	6.1	5.7	6.7	4.2	4.4	3.8	2.2	2.5	2.3
Total	24.1	23.0	20.2	18.0	16.3	11.7	12.6	11.1	7.3		

Source: NERA/OPM (2004).

The total impact on employment of the decline in the banana sector is much greater than the number of registered farmers suggests. The number of workers deriving income from banana production exceeds the number of farmers by a factor of three (see Table 20).

Table 20: Windward Islands Population, Labour Force and Banana Industry Employment, 2000

1000s	**Dominica**	**Grenada**	**St. Lucia**	**St. Vincent**	**Total**
Labour force	34.0	42.3	73.7	43.0	192.9
No. employed	26.1	35.1	57.3	34.4	152.9
No. unemployed	7.9	7.2	16.4	8.6	40.0
Unemployment rate (%)	23.2	17.0	22.2	20.0	20.7
Banana employment	9.0	0.2	13.8	12.7	35.8
Banana employment as % of population	12	0.2	9.3	11.4	8.2
Banana employment as % of labour force	26.6	0.5	18.8	29.5	18.6
Rural banana employment as % of rural labour force	68.2	0.6	23.4	45.5	20.2

Source: Sandiford (2000).

This suggests that the total decline in employment from the banana sector could be as high as 67,000, or 18% of the working population (NERA/OPM, 2004). However, exact estimations of employment and wages are complicated by the use of family labour by some farmers. For example, in Dominica household members are estimated to make up

over 40% of the agricultural workforce (FAO, 1995). It is also important to consider employment in ancillary services linked to banana production since many other workers are temporarily involved in the transportation, harvesting and packaging of bananas for export in the Eastern Caribbean (ILO, 1999). Godfrey (1998) estimates that the livelihoods of over 60,000 people (one third of the population) depend on the banana industry in St. Lucia. In St. Vincent the proportion is almost 70 percent. During 1988-92, the banana industry in Dominica employed 60% of agricultural workers (CBEA, 1997).

The decline in banana production has created hardship for a number of smallholder producers in the Caribbean but the impact has been limited, to some extent, by a number of factors relating to the demographic structure of the workforce.

First, the average age of workers remaining in the banana sector in the Windward Islands is 55, so that most leaving the industry are close to retirement and often do not seek re-employment (European Commission, 2004e). Second, many workers operate only on a part-time basis which may limit their losses. Third, service industries (mainly tourism) have now become the principal source of employment for younger workers entering the labour force. Finally, emigration is increasing and remittances of income earned abroad is playing an important role supporting communities affected by declining banana production.

4.1.2 The impact of a tariff-only regime

A recent study by NERA/OPM (2004) addresses the impact of the post-2006 regime on banana production in Caribbean ACP countries. First, the study uses a price gap method to derive the third-country tariff that would replicate the import price and volume in the EU banana market generated by the existing quota regime. Based on the difference between average export unit values between Latin American and ACP Caribbean banana-producing countries (from 1999 to 2002) the study estimates a tariff equivalent (which would need to be imposed on Latin American producers) of €259/tonne (see Table 21). In October 2004, the EU proposed a tariff of €230/tonne which approximates to the price gap calculated for 2002.

Table 21: Banana export unit values (f.o.b., €/tonne)

	1994	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**Average 99-02**
ACP Caribbean	428	375	401	467	497	506	538	550	488	520
Latin America	219	208	220	256	253	246	260	286	255	261
Price gap	208	166	181	211	244	260	278	265	233	259

Source: NERA/OPM (2004).

The methodology used to calculate the price gap between export unit values for the Caribbean ACP countries *as a whole* and Latin America ignores inter-country variations among the Caribbean ACP group. Based on export unit values Table 22 shows that banana exports to the EU from all countries except Jamaica would remain viable under the tariff equivalent proposed in the study of €259/tonne. Adoption of the EU's proposed tariff preference of €230/tonne would maintain share in the EU market for all countries except Belize and Jamaica.

Table 22: Banana export unit values (f.o.b., €/tonne)

	1994	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**Average 99 - 02**	**Average price gap 99-02**
Latin America	219	208	220	256	253	246	260	286	255	262	
Dominica	398	393	338	406	436	487	478	519	469	488	226
Grenada	395	343	260	260	294	219	340	360	406	331	69
St. Lucia	430	383	412	416	539	463	472	n.a.	479	471	209
St. Vincent	408	345	335	388	456	479	457	457	446	460	198
Belize	431	395	403	431	432	455	526	493	504	495	233
Jamaica	515	427	406	526	518	590	561	525	536	553	291
Dominican Republic	141	105	116	128	172	255	271	309	459	324	62

Source: Inferred from NERA/OPM (2004).

These results, however, *ignore any supply response*. At a lower EU price, countries may reduce their banana exports rather than ceasing them altogether. The study proceeds to account for this by using a simple partial equilibrium model of the EU banana market to estimate the effects on Caribbean exports of bananas if a tariff lower than €259/tonne is chosen. Assuming perfectly elastic supply for Latin American producers and different supply elasticities for Belize (1.4), Dominica (11.2), St. Lucia (4.8), St. Vincent (6.3) and Jamaica (3.5), the study projects that EU banana imports from the Caribbean decline as lower third-country tariff levels are adopted (see Table 23).[22]

Table 23: Banana export projections for different tariff scenarios

			Change in banana exports (to EU) caused by tariff level (assumed supply elasticities in brackets)				
Tariff €/tonne	**f.o.b. price** €/tonne	**Price reduction**	**Belize** (1.4)	**Jamaica** (3.5)	**Dominica** (11.2)	**St. Lucia** (4.8)	**St. Vincent** (6.3)
259	520	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
250	511	-1.7%	-2.4%	-6.1%	-19.4%	-8.3%	-10.9%
225	486	-6.5%	-9.0%	-22.9%	-73.2%	-31.4%	-41.2%
200	461	-11.3%	-15.5%	-39.7%	-100.0%	-54.5%	-71.5%
175	436	-16.2%	-22.1%	-56.5%		-77.5%	-100.0%
150	411	-21.0%	-28.7%	-73.4%		-100.0%	
125	386	-25.8%	-35.3%	-90.2%			
100	361	-30.6%	-41.9%	-100.0%			
75	336	-35.4%	-48.5%				
0	261	-49.8%	-68.2%				

Source: Adapted from NERA/OPM (2004).

When supply responses are considered, with the notable exception of Belize, none of the Caribbean suppliers is projected to continue supplying bananas under a tariff of €75/tonne. St. Lucia, St. Vincent and Dominica stop supplying bananas with tariffs below €150/tonne, €175/tonne and €200/tonne respectively. However, these supply projections based on constant elasticities may be less reliable for large changes in price. In particular, there are economies of scale for transportation of bananas and so unit costs may rise with lower export volumes.

Under each tariff scenario, the estimated impact on export volumes is then multiplied by the average Caribbean ACP export unit value in order to project the foreign exchange implications of a tariff-only regime (see Table 24).

[22] Projections were not made for Suriname, because of uncertainty regarding the bankruptcy of Surland, and for Grenada, where banana exports are low.

Table 24: Projected exports at different tariff levels

	Tariff €/tonne	f.o.b. price €/tonne	Projected volume of exports, tonnes (value in brackets, € millions)				
			Belize	**Jamaica**	**Dominica**	**St. Lucia**	**St. Vincent**
Av. exports 1999-2002[23]			53,525 (26.4)	44,025 (24.4)	22,575 (12.0)	55,525 (25.0)	36,025 (18.0)
Projected exports at tariff levels	259	520	53,525 (27.8)	44,025 (22.9)	22,575 (11.7)	55,525 (28.9)	36,025 (18.7)
	250	511	52,240 (26.7)	41,339 (21.1)	18,195 (9.3)	50,916 (26.0)	32,098 (16.4)
	225	486	48,708 (23.7)	33,943 (16.5)	6,050 (2.9)	38,090 (18.5)	21,183 (10.3)
High tariff scenario	200	461	45,229 (20.8)	26,547 (12.2)	0	25,264 (11.7)	(10,267) 4.7
	175	436	41,696 (18.2)	19,151 (8.3)	0	12,493 (5.4)	0
	150	411	38,163 (15.7)	11,711 (4.8)	0	0	0
Low tariff scenario	125	386	34,631 (13.4)	4,314 (1.7)	0	0	0
	100	361	31,098 (11.2)	0	0	0	0
	75	336	27,565 (9.3)	0	0	0	0
	0	261	17,021 (4.4)	0	0	0	0

Source: Adapted from NERA/OPM (2004).

Under the proposed €230/tonne tariff, African ACP producing countries (and possibly the Dominican Republic) might be able to increase exports to the detriment of Latin America, since under the existing tariff quota they are prevented from exporting more. It is unlikely, however, that Latin American producers and US multinational companies will accept such a high third-country tariff, especially given the conditions of the Cotonou waiver (see Section 3.1). The tariff would reduce Latin American exports by a third compared to the current in-quota tariff of €75/tonne (FLASCO, 2004).

In order 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 Dominica, St. Lucia and St. Vincent would cease or be obliged to move into some higher-value niche market.

[23] Actual reported export values differ from the projected values under the quota-equivalent tariff scenario because the authors infer these from average ACP f.o.b. export unit values rather than use country-specific f.o.b. export unit value data.

At a tariff level of €125/tonne the Windward Islands would experience a loss in annual export earnings of between €12 million (Dominica) and €25 million (St. Lucia) – declines of a similar magnitude to those experienced from previous reforms to the COMB in the 1990s (see Table 25). As a proportion of total export earnings and GDP the loss would be greatest for St. Vincent (10.3 percent of total export earnings and 5.2 percent of GDP).

Table 25: Projected change in banana export revenues at different tariff levels

	Tariff €/tonne	**f.o.b. price €/tonne**	**Change in export revenue, € millions (as % of total exports) [as % of GDP]**				
			Belize	**Jamaica**	**Dominica**	**St. Lucia**	**St. Vincent**
Projected export revenue loss at tariff levels	259	520	0.0 (0.0%) [0.0%]	0.0 (0.0%) [0.0%]	0.0 (0.0%) [0.0%]	0.0 (0.0%) [0.0%]	0.0 (0.0%) [0.0%]
	250	511	0.0 (0.0%) [0.0%]	-3.3 (-0.1%) [0.0%]	-2.7 (-1.9%) [-1.0%]	0.0 (0.0%) [0.0%]	-1.6 (-0.9%) [-0.5%]
	225	486	-2.7 (-0.6%) [-0.3%]	-7.9 (-0.2%) [-0.1%]	-9.1 (-6.6%) [-3.5%]	-6.5 (-1.7%) [-1.0%]	-7.7 (-4.4%) [-2.2%]
High tariff scenario	200	461	-5.6 (-1.3%) [-0.7%]	-12.2 (-0.4%) [-0.2%]	-12.0 (-8.6%) [-4.6%]	-13.3 (-3.5%) [-2.0%]	-13.3 (-7.6%) [-3.9%]
	175	436	-8.2 (-1.9%) [-1.1%]	-16.1 (-0.5%) [-0.2%]	-12.0 (-8.6%) [-4.6%]	-19.6 (-5.2%) [-3.0%]	-18.0 (-10.3%) [-5.2%]
	150	411	-10.7 (-2.5%) [-1.4%]	-19.6 (-0.6%) [-0.3%]	-12.0 (-8.6%) [-4.6%]	-25.0 (-6.7%) [-3.8%]	-18.0 (-10.3%) [-5.2%]
Low tariff scenario	125	386	-13 (-3.0%) [-1.7%]	-22.7 (-0.7%) [-0.3%]	-12.0 (-8.6%) [-4.6%]	-25.0 (-6.7%) [-3.8%]	-18.0 (-10.3%) [-5.2%]
	100	361	-15.2 (-3.5%) [-2.0%]	-24.4 (-0.8%) [-0.3%]	-12.0 (-8.6%) [-4.6%]	-25.0 (-6.7%) [-3.8%]	-18.0 (-10.3%) [-5.2%]
	75	336	-17.1 (-3.9%) [-2.2%]	-24.4 (-0.8%) [-0.3%]	-12.0 (-8.6%) [-4.6%]	-25.0 (-6.7%) [-3.8%]	-18.0 (-10.3%) [-5.2%]
	0	261	-22.0 (-5.0%) [-2.8%]	-24.4 (-0.8%) [-0.3%]	-12.0 (-8.6%) [-4.6%]	-25.0 (-6.7%) [-3.8%]	-18.0 (-10.3%) [-5.2%]

Source: Adapted from NERA/OPM (2004) and World Bank (2004b).

4.2 Sugar

Unlike the EU market for bananas, the basic support system for sugar has changed very little since its inception in 1968. As such, studies have focused on estimating the value of income transfers to ACP Sugar Protocol countries arising from the current regime and predicting the changes to these under various reform scenarios.

4.2.1 Income transfers from the Sugar Protocol

The importance of income transfers from the Sugar Protocol both in absolute and relative terms (as a proportion of national income and total export earnings) varies significantly across the Protocol countries (see Table 26). The total transfer to the ACP Sugar Protocol countries associated with quota access to the protected EU market is about US$500 million or about 60 percent of the value of these countries' sugar exports to the EU (Milner *et al.*, 2003; LMC/OPM, 2004). Mauritius receives over a third of the total transfers and the five largest quota-holders (Mauritius, Fiji, Guyana, Jamaica and Swaziland) receive over three-quarters of the total transfer. The concentration of transfers means that the proposed reforms to the COMS will have different impacts across the Protocol countries.

The Sugar Protocol makes a significant contribution to foreign exchange earnings in Guyana, Mauritius, Fiji, Swaziland, and St. Kitts, where it accounts for over 5 percent of total export earnings. For other countries it is moderately important (approximately 4 percent for Malawi and Jamaica). In relative income terms the transfer arising from the Sugar Protocol is most important for Guyana, contributing approximately 10 percent to GDP.

Table 26: Estimates of income transfers under the Sugar Protocol

	McDonald (1996) 1/			Milner *et al.* (2003) 2/			LMC/OPM (2004) 3/		
	Transfer US$ million	*% of GDP*	*% of total exports*	*Transfer US$ million*	*% of GDP*	*% of total exports*	*Transfer US$ million*	*% of GDP*	*% of total exports*
Barbados	7.7	0.4%	0.6%	16.2	0.6%	1.2%	24.7	1.1%	2.3%
Belize	6.2	1.0%	2.0%	14.8	1.9%	3.3%	17.1	2.5%	4.9%
Congo	1.6	0.0%	0.1%	0.7	0.0%	0.1%	5.4	0.2%	0.3%
Côte d'Ivoire	1.6	0.0%	0.0%	3.3	0.0%	0.1%	7.7	0.1%	0.2%
Fiji	25.4	1.2%	2.0%	48.8	2.9%	4.9%	69.5	4.7%	7.3%
Guyana	24.5	3.5%	3.4%	60.9	8.7%	8.9%	61.3	10.1%	11.4%
Jamaica	18.2	0.3%	0.6%	46.4	0.6%	1.4%	53.2	0.8%	1.8%
Kenya	n.a.	n.a.	n.a.	1.2	0.0%	0.0%	n.a.	n.a.	n.a.
Madagascar	1.7	0.0%	n.a.	4.9	0.1%	0.4%	10.3	0.3%	0.8%
Malawi	3.2	0.1%	0.6%	12.2	0.7%	2.7%	13.8	1.1%	4.0%
Mauritius	75.3	1.8%	2.9%	180.7	4.0%	6.5%	205.6	5.2%	8.0%
St. Kitts	2.4	1.0%	2.0%	0	0.0%	0.0%	7.3	2.4%	5.4%
Suriname	n.a.	n.a.	n.a.	0	0.0%	0.0%	n.a.	n.a.	n.a.
Swaziland	18.1	1.4%	n.a.	56.4	4.3%	5.0%	57.4	5.3%	8.6%
Tanzania	1.6	0.0%	0.1%	4.5	0.0%	0.3%	4.3	0.1%	0.9%
Trinidad & Tobago	6.7	0.1%	0.2%	14.7	0.2%	0.3%	20.1	0.3%	0.5%
Uganda	n.a.	n.a.	n.a.	0	0.0%	0.0%	n.a.	n.a.	n.a.
Zambia	n.a.	n.a.	n.a.	4.8	0.1%	0.7%	5.6	0.2%	1.2%
Zimbabwe	4.6	0.1%	0.1%	19.9	0.2%	0.9%	20.9	0.3%	1.3%
Total Sugar Protocol	**198.6**			**490.1**			**584.2**		
India	1.5			n.a.			n.a		

1/ Constant 1987 prices, predicted 2000 transfers.
2/ Constant 2001 prices. Uganda, St. Kitts and Suriname did not export sugar to the EU in 2001.
3/ Average 2000-2002 prices.

Similarly, the impact of the Sugar Protocol on employment varies considerably across countries, although the exact relationship is difficult to estimate. Table 27 illustrates the number of people dependent on production both directly employed in the sugar industry and indirectly on a seasonal basis or in ancillary services. In terms of direct employment, over 5 percent of the labour force is employed in the sugar industry for Belize, St. Kitts, Guyana, Fiji and Mauritius.

Table 27: Employment in the sugar industry, Average 2000-2002

	Directly employed	Indirectly employed	Total
Barbados	2,612	6,000	8,612
Belize	10,290	1,000	11,290
Congo	1,000	3,400	4,400
Côte d'Ivoire	5,000	17,000	22,000
Fiji	23,132	70,000	93,132
Guyana	23,860	8,000	31,860
Jamaica	32,729	15,000	47,729
Kenya	n.a.	n.a.	n.a.
Madagascar	24,300	9,000	33,300
Malawi	16215	5600	21815
Mauritius	28,144	20,000	48,144
St. Kitts	1,766	7,000	8,766
Suriname	n.a.	n.a.	n.a.
Swaziland	17,174	80,000	97,174
Tanzania	23,075	20,000	43,075
Trinidad & Tobago	24,410	11,000	35,410
Uganda	n.a.	n.a.	n.a.
Zambia	7,000	55,000	62,000
Zimbabwe	27,189	135,000	162,189

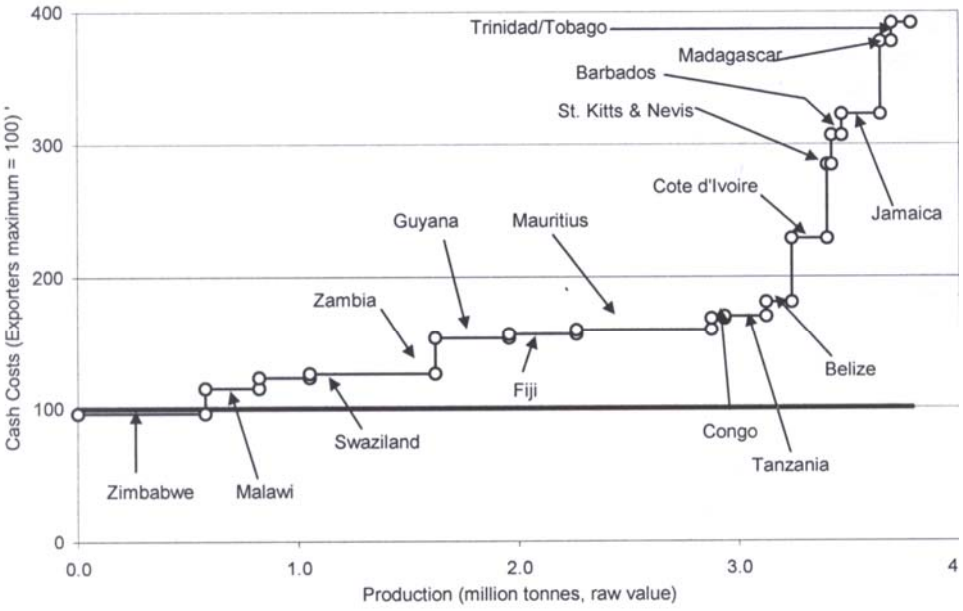
Source: Adapted from LMC/OPM (2004).

4.2.2 The impact of reform of the EU's Sugar Regime on Protocol signatories

The greatest losses in the EU market arising from reform of the COMS will be incurred by Guyana, Mauritius, Swaziland, Fiji and Belize since these countries currently have the largest quota allocations and receive the highest income transfers (both in absolute terms and as proportions of national income and total export earnings).

Under the current proposals for reform, the real price offered to ACP Sugar Protocol producers will be substantially reduced (see Section 3.2.5). This will result in sugar production in a number of higher-cost ACP Protocol countries (Barbados, Jamaica, Madagascar, St. Kitts and Trinidad) becoming unprofitable without effective investment in cost-saving production (see Figure 8). Some processing companies based within these countries may be able to adjust by relocating to more efficient locations. 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.

Figure 8: Sugar production costs, average 2000-03



Production costs (on an f.o.b. basis) relative to those associated with the leading sugar exporting countries (=100).

Source: LMC/OPM (2004).

However, production in a number of ACP countries which are classified as Least Developed (e.g. Republic of Congo, Mozambique and 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 Economic Partnership Agreements or the Everything But Arms Initiative). The latter benefits LDCs with no previous quota allocation under the Sugar Protocol against the quota holders in the Caribbean, Mauritius, Fiji and Swaziland.

A number of studies have analysed the quantitative impact of sugar policy reform varying from single country to complete world market liberalisation (see Table 28). For total OECD liberalisation the predicted percentage increases in the world price are between 10-60 percent, although it is important to note these estimates are sensitive to assumptions made about the supply responses of major suppliers and the demand for substitutes (e.g. artificial sweeteners).

Table 28: Impact of liberalisation on world sugar prices

Author	Base period	Change in world price %	Scenario
Anderson & Tyers (1986)	1986	10	Liberalisation by East Asia & Western Europe
Webb *et al.* (1987)	1984	53	Complete liberalisation
OECD (1988)	1979-81	11	Reduction in support to OECD sugar producers
Wong *et al.* (1989)	1985	33	Liberalisation of Japan, EU & US markets
Borrell & Duncan (1990)	1984	17	Complete EU liberalisation
Huff & Moreddu (1990)	1982-88	5-25	Multilateral trade liberalisation
Lord & Barry (1990)	1990	10-30	Multilateral trade liberalisation
UNCTAD (1995)	2000 projection	5	Implementation of Uruguay Round
ABARE (1998)	2000 projection	5.3	Implementation of Uruguay Round
Borrell & Pearce (1999)	2000	38	Complete liberalisation
Borrell & Hubbard (2000)	2000	30-38	Complete liberalisation
NEI (2000)	2000	8	10% cut in EU production quotas
CIE (2002)	2000	3 16	EU doubles import quotas EU intervention price halved

Source: Adapted from Milner *et al.* (2003).

In terms of the impact on ACP Sugar Protocol countries, Borrell and Hubbard (2000) estimate that complete liberalisation of the sugar market would lead to a loss in income transfers of US$400 million per annum. However, some of this loss would be partially

offset by exports to the world market which would now receive a 30-38 percent higher price.

Taking the assumption that full OECD liberalisation in the sugar market would raise world prices by 38 percent (implying a reduction of 52 percent in EU import prices) Milner *et al.* (2003) estimate the impact on ACP Sugar Protocol countries from reform of the COMS under four scenarios: 1) compliance with the recent WTO ruling in favour of Brazil, Australia and Thailand (reducing subsidised exports by 68.8 percent - 2.8 million tonnes); 2) simulation 1 plus further multilateral liberalisation (reduction in subsidised exports by a further 21.2 percentage points and out-of-quota tariffs reduced by 30 percentage points); 3) simulation 2 plus major reform of the CAP (export subsidies are eliminated and out-of-quota tariffs are reduced by a further 20 percentage points); and, 4) full OECD liberalisation. Assuming unitary export supply elasticities, the predicted decline in the net income transfer to the ACP Sugar Protocol countries is between US$13.4 million (simulation 1) and US$447.5 million (simulation 4). Estimated losses under the intermediate scenarios are in the order of US$70.7 million (simulation 2) to US$158.3 million (simulation 3). There are, however, marked inter-country variations in the pattern of effects (see Appendix 17). For all countries, under all the simulations, there is a reduction in the gross income transfer from the EU, which results from the fall in the domestic EU price (inducing a reduction in exports). The greatest losses are for those countries which export sugar only or predominantly to the EU and have the biggest quotas (Mauritius, Guyana, Fiji and Barbados). In contrast, there is a rise in income on non-EU sugar exports following the world price rise. For some countries the net impact on export earnings is found to be positive mostly so for India (but also for Congo, Côte d'Ivoire, St. Kitts, Swaziland, Zambia and Zimbabwe).

The implications for non-Protocol developing countries are similarly mixed depending on whether they are net sugar exporters or importers and whether they have specific trade agreements with the EU. Large exporting countries such as Brazil and the Dominican Republic are predicted to gain from any reform that increases the world price of sugar, reduces competition in export markets from EU subsidised sugar or improves EU market access. However, non-Protocol ACP countries as a net sugar-importing group will probably be worse off from higher world sugar prices: Milner *et al.* (2003) estimate losses of between US$54 million (simulation 1) to US$121 million (simulation 4).[24] Only a few non-Protocol ACP countries which are net exporters of sugar are predicted to gain: Dominican Republic, Ethiopia, South Africa and Papua New Guinea.

These results ignore the impacts of reform for some sugar exporting developing countries that depend not only on what happens to world prices but also on what happens to the EU price and their access to the EU market outside of the Sugar Protocol. EBA, in particular, will provide duty-free and quota-free access to the EU market for LDCs after 2009. For the Western Balkan countries the Commission is proposing to maintain their benefits by introducing a tariff quota at levels that would preserve their present export levels to the EU (Milner and Morgan, 2004).

[24] These losses are relatively small representing less than 0.1% of GDP for the group of countries.

5. Transitional assistance for preference erosion

The previous chapter discussed the impact on ACP countries arising from possible reform of the COMB and the COMS. While the estimated effects 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 adversely affected countries. While the focus of this in the following sections is on the sugar sector, where preference erosion has yet to occur, these principles should also be applicable to bananas, where transitional support has already been provided in response to reform of the EU's Banana Regime, and other products where high preferential margins exist e.g. clothing and textiles.

5.1 Approaches to assistance

The European Commission is proposing specific measures to assist the Sugar Protocol countries in adjusting to the changes in the COMS scheduled to begin in 2006. 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.

There are, in principle, two broad approaches available for using transitional assistance for preference erosion:

1) *compensation* for lost income transfers (to governments, sugar/banana companies or associations) including poverty mitigation measures (to workers/households);
2) support for *restructuring* production either to increase the competitiveness of the sectors or to develop new sectors (such support could go to governments or sugar/banana companies and other firms).

The EU's commitments under the Cotonou Agreement to ensure the continued viability of the Protocol industries will be difficult, if not impossible, to maintain in higher-cost countries following reform of the COMB and the COMS and the full implementation of EBA. The only way to maintain industries would be to offer some form of direct aid to producers. This has been proposed by some Sugar Protocol countries, who have argued that any compensation for reform of the COMS be based around the principle that ACP sugar suppliers should receive equivalent treatment to that which will be provided for EU beet producers (i.e. decoupled support paid directly to producers).

Paying compensation for lost income transfers arising from preference erosion to producers has a number of shortcomings, all of which apply equally to the measures that

the EU is proposing for its own farmers (Table 1 summarises the various potential forms of assistance and the arguments for and against them).

First, there is no justification on welfare grounds to give additional income to producers or workers damaged by trade over those damaged by other shocks or those who are simply poor. It may be accepted at a national level, especially if it is directed at obviously temporary needs e.g. to pension off employees in the declining sectors. But a country must ultimately adjust to a permanent shock, so compensation at national levels may provide the wrong incentive if it is used to delay restructuring and diversification.

Transitional assistance measures, therefore, should not simply compensate for lost income transfers but facilitate the necessary adjustment in anticipation of a preference erosion shock. In order to achieve this, they should provide support for increasing competitiveness and/or diversification. They should disburse funds *ex ante* in order to provide timely resources for investment: unlike commodity price volatility or natural disasters preference erosion *is* predictable and the associated losses can be estimated before the shock occurs. The sugar producers are right to argue that 'uncertainty will deter investors and prevent restructuring' (ACP Workshop, 2004).

5.2 Existing instruments

The EU has already used a number of financial instruments to support the restructuring of industries adversely affected by preference erosion. These include the Special Framework for Assistance (SFA) for traditional ACP suppliers of bananas, FLEX (the successor to STABEX) and the EU Rum Programme for the Caribbean ACP. There have also been multilateral initiatives providing assistance for countries facing balance of payments shortfalls such as the Trade Integration Mechanism. A number of lessons can be drawn from the experiences with these schemes.

5.2.1 The Special Framework for Assistance

The Special System of Assistance (SSA) was created in 1994 to facilitate adjustment in the 12 traditional ACP banana-producing countries which had been necessitated by the establishment of the COMB. The SSA provided 95 million ECU for income support to improve the quality and marketing of bananas. Of this, 75 million ECU was given over three years to seven banana producers. The SSA was followed in 1999 by a further ten-year programme, the Special Framework for Assistance (SFA), which aimed to improve productivity in response to reforms made to the COMB in 1998. The SFA provided a much greater level of funding than the SSA: €45 million per year.

Both the SSA and the SFA placed strong emphasis on projects to improve field productivity (e.g. irrigation and drainage) as well as reforming marketing organisations and diversification projects (mainly within agriculture).

The SFA has been criticised on several grounds. A major failure has been its tendency to support banana production in those countries that have limited potential to become competitive. Only in some African countries (Côte d'Ivoire and Cameroon) has financing been effective in increasing productivity in the banana industry. This was largely as a result of it being used by multinational companies to complement their own investments (in productive facilities) by funding the development of cableways, drainage and irrigation. Support has not been the critical factor in increasing investment in the industry: prospects for market access and prices have been more important determinants (Hubbard *et al.*, 2000; European Commission, 2002).

Table 29: Annual commitments under the Special Framework for Assistance (€ million)

	1999	2000	2001	2002	2003	Average
Belize	3.10	3.10	3.35	3.50	3.20	3.25
Dominica	6.50	6.50	6.70	6.40	5.90	6.40
Grenada	1.00	0.50	0.50	0.50	0.50	0.60
Jamaica	5.30	5.30	5.00	4.70	4.40	4.94
St. Lucia	8.50	8.88	9.20	8.80	8.00	8.68
St. Vincent	6.10	6.45	6.40	6.10	5.60	6.13
Suriname	3.10	2.70	2.70	2.50	2.20	2.64

Source: NERA/OPM (2004).

Country allocations for the SFA (as for the SSA) are determined on the basis of the size of the banana industry within the ACP country and a competitiveness gap formula. The competitiveness gap formula is defined as the difference between the average EU import unit value (c.i.f) from the ACP country over the preceding three years and the average EU import unit value (c.i.f) from the most competitive non-ACP country over the same period (European Communities, 1999). This measure favours an allocation of funds to higher cost banana producers, such as the Windward Islands (Hubbard *et al.*, 2000). Corrective measures have been introduced and, from 2004, country allocations under the SFA will be reduced by a maximum of 15 percent per year. The exact mechanism for determining such reductions, and whether every country allocation will be cut, has yet to be decided but they will be linked to gains in competitiveness: countries which improve competitiveness will have their allocations reduced less rapidly.

Some recipients (e.g. the Windward Islands) have failed to make the best use of the transitional assistance programmes that have been agreed. Radical reforms, required to enable the industry to survive, have constantly faced opposition from individual growers' associations and by governments unwilling to back locally unpopular decisions. Several country programmes (e.g. Jamaica and St. Vincent) have used the funds provided to

subsidise farmers' operating costs rather than finance new investments hindering efforts to improve competitiveness.

The low share of SFA funds spent on diversification has been raised as an important factor in the low levels of growth experienced in traditional ACP banana-producing countries, despite substantial financing (Commonwealth Secretariat, 2004). Following several critical evaluations of the SFA, the Commission has promoted more use of it for diversification financing. Spending on diversification projects has increased from 12 percent of funds in 1999 to 64 percent in 2002 (European Commission, 2002). Since 1999, much of the support in Dominica, St. Vincent and Grenada has been directed towards diversification into the production of other fruits and vegetables. Since 2002, Jamaica has also used a proportion of its grant for diversification purposes. However, most of the diversification projects funded under the SFA have been small-scale pilot projects within the agricultural sector. The approach has been rather *ad hoc* and has not addressed the key constraints in the wider business environment (e.g. public sector reform). Action to remove these would have promoted economic diversification covering all potential sectors. The lack of consistency in the EU approach to funding - specifying, initially, that funds be used for investments in the affected industry and, later, insisting on diversification – has created uncertainty and hampered investment.

5.2.2 STABEX and FLEX

The EU has made financial transfers under the Lomé Conventions to national governments in ACP countries to compensate for declining and volatile export earnings.

The EU-ACP STABEX arrangement was established in 1975 under the first Lomé Agreement and continued through until the 2000 Cotonou Agreement. STABEX transfers totalled €4.4 billion and were by far the fastest disbursing instrument in the EU's aid portfolio. One of the most controversial and debated aspects of STABEX was its product coverage. Although the list of eligible products was extended from 29 in Lomé I to 49 by Lomé IV, sugar, meat and tobacco were never included for support: a choice that could not be justified on the grounds that some of these (meat and sugar) were included in preferential agreements because STABEX covered bananas (Hewitt, 1996). However, the fact that sugar was not covered under STABEX also reflected the fact that the Sugar Protocol trade arrangement was neither a formal aid mechanism nor was it financed under the European Development Fund (EDF).

Several Caribbean countries have benefited from significant STABEX funding to meet export losses in the banana sector. STABEX funding for the Windward Islands has been roughly equivalent to the combined support received from the SSA and SFA. Although STABEX has been discontinued there are considerable unspent funds that will carry on being spent for at least a few years

In the form in which it operated in the 1990s, the instrument had serious drawbacks. First, transfers had to be used by the recipient governments to support the commodity sector that had suffered the export loss, even if this aggravated the commodity dependence problem. Second, the EU placed ever-greater restrictions on the use of transfers, which had to be spent according to provisions negotiated with each recipient country, so transfers frequently remained unspent for long periods of time. Third, time delays built into the system for assessing and making transfers and approving expenditures, coupled with the cyclical nature of international prices for commodities, meant that support often arrived just as export revenues were rebounding, exacerbating rather than mitigating the impact of any price instability (Hewitt, 1996).

Under the Cotonou Agreement, a new instrument was established (financed by the 9th EDF) to compensate countries for sudden falls in export earnings. FLEX provides general budget support rather than sector-specific allocations (so sugar, in theory, is now included) and allows ACP governments to use the finance for a wider range of purposes e.g. in order to safeguard macroeconomic and sectoral reforms. It provides support to countries that have registered a 10 percent loss in exports earnings (2 percent in the case of LDCs) *and* a 10 percent worsening of the programmed public deficit. For landlocked countries and island states the eligibility threshold has been lowered to 2 percent loss of export earnings and to 2 percent the worsening in the programmed public deficit (European Commission, 2004a).

5.2.3 The Rum Programme

The Rum Protocol existed between 1975 and 2001 as part of the successive Lomé agreements. Under it, Caribbean ACP countries received quota-restricted duty-free access to the EU market for their aged brown rums and bulk white rum exports. Quantitative restrictions were to protect French interests for their rum produced in Martinique, Guadeloupe and Réunion. In November 1996, at the Singapore WTO Ministerial, the EU agreed to liberalise its market for white spirits including gin, vodka and rum in return for better access to the US technology market. In accordance with the MFN principle these concessions had to be extended to all exporters including imports of rum from Brazil, Panama, Mexico and Venezuela. Under the agreement, four of the six tariff lines for rum were reduced to zero by 2003. Low tariffs continue to apply on the two remaining tariff lines (providing small preferences for ACP rum exports) but these will be phased out by 2010. Losses to the Caribbean ACP rum producers due to preference erosion have been estimated to be US$260 million per year (European Commission, 2003b) although these have been partially offset by the removal of quota restrictions under the Cotonou Agreement (which replaced the Rum Protocol).

During the phasing out of preferences, the West Indies Rum and Spirit Producers' Association (WIRSPA) argued successfully that transitional assistance be provided for the Caribbean rum industry. In December 1999, the EU Rum Programme was agreed (financed from the EDF but deducted from regional aid programmes) which aimed to

support the modernisation of distilling industries and the development of higher value-added rum products. The Rum Programme was divided into four 'windows' each having a separate budget and ceilings governing the maximum grant to an eligible recipient. In 2001, the EU approved a four-year package of transitional support with an EDF contribution of €70 million. This was allocated as follows:

- €14.7 million for modernisation of distilleries;
- €21.7 million for distribution and marketing;
- €9.8 million for waste treatment and disposal of molasses; and,
- €3.5 million to develop business plans for small companies.

Sums outside these windows also went to the development of Caribbean brands (€16.1 million) and WIRSPA itself to administer the programme (€2.1 million).

The Rum Programme has been one of the few instances where EU aid has been provided *directly* to the private sector and not simply divided up between governments. It attracted a high degree of regional ownership and because of this showed some success. However, rum has always been closer to being competitive on world markets than bananas or sugar. Indeed, during the 1970s, rum was the only manufactured export from the ACP holding its own on world markets.

5.2.4 The Trade Integration Mechanism

In April 2004, the IMF approved the Trade Integration Mechanism (TIM) designed to 'mitigate concerns that implementation of WTO agreements might give rise to temporary balance of payments shortfalls' (IMF, 2004c). There had been IMF precursors: the Compensatory Financing Facility, especially in the 1980s and 1990s, the Compensatory and Contingency Financing Facility in the later 1990s and a Food Import Facility. The TIM provides enhanced access to existing IMF facilities based on estimated preference erosion losses. Its first disbursements were made to Bangladesh in 2004. The IMF estimates that additional demand for PRGF resources from a successful completion of the Doha Round could be in the order of SDR500-600 million. Although the World Bank is concerned about HIPC countries facing falling commodity export incomes, it has been less convinced that there is a need for special measures to compensate for preference erosion on developmental grounds, arguing that the most preference-dependent countries are not the poorest and that losses could be compensated through diversification, trade facilitation and more liberal rules of origin (Page and Kleen, 2004).

5.2.5 Lessons learned from existing schemes

Clearly, no matter how well a scheme is designed it can be used efficiently or inefficiently. However, a number of lessons can be learned for transitional assistance from the experience of existing mechanisms discussed above. First, in order to facilitate adjustment and avoid nurturing dependency on preferences, support needs to be de-linked from production. The SFA and STABEX (initially) compensated for loss of export earnings in declining commodity sectors which aggravated dependence. Second, in order to be effective any scheme needs to be predictable (without frequent changes in how the funds can be spent) since this will encourage investment. Both the SFA and STABEX have been undermined by seemingly conflicting conditionality in the course of their lifetimes. Third, strict regulation of conditions should be avoided since this could delay disbursements and limit the potential to use transitional assistance effectively. Fourth, financing should be provided *ex ante* so that the required investments can be made in anticipation of the preference erosion shock (e.g. as with the Rum Programme). Finally, strong national or regional ownership of the scheme, with close relationships between the public and private sectors, help to ensure that funds are used effectively.

A number of authors (e.g. the Commonwealth Secretariat, 2004; Page and Kleen, 2004) have advocated the development of a new fund to provide eligible countries with financing to compensate them for preference erosion. From the lessons drawn above, a new fund for preference erosion should act as a diversification enhancement scheme to avoid fixing countries and economies into outmoded trade and production patterns. The fund would also have to be bound and contributions made to it irrevocable to ensure predictability. Funding would not be permanent (tapering off over a period of adjustment – see Section 5.5).

5.3 Options for transitional assistance: a decision framework

Taking into account, but not limited to, the types of support offered by the existing transitional assistance measures, there are a number of trade and financial mechanisms that could be used by the EU in supporting ACP Protocol countries. There is no unique model for assisting all countries, and even within individual countries a mixed approach may be required, but options would include measures to improve the competitiveness of industries producing particular products or located within certain geographic regions, closing higher-cost and less profitable operations and diversifying out of the declining commodity into related-products or new sectors. Each can be associated with a number of potential benefits and problems (see Table 1).

5.3.1 Trade instruments

The use of trade instruments, which favour imports from a group of preferred trading partners over others, as transitional assistance measures are problematic: they can cause trade diversion (distorting trade to the detriment of exporting-countries excluded from the favoured group) and could create or increase dependence on preferences. Nevertheless they do present a possible option, not least because they do not entail a direct budgetary cost.

Delay

Reform could be delayed in order to allow the ACP trading partners time to adjust to the prospect of a lower domestic EU price or more intense competition from third countries. Although delaying reform cannot be strictly classified as transitional assistance - countries must still face the costs of transition - postponing reform for sugar is attracting increasing support from a number of Caribbean countries and sympathy from the European Commission (see Box 1). On the one hand, the Caribbean ACP argue that costly restructuring and sugar-related diversification efforts have already started in a number of countries (in Guyana, to some extent in Belize, but less so in Jamaica). The cost savings from these efforts are still coming into effect and will not be fully realised until 2006 (in the case of Guyana around 2007). In addition, loans (financed by current income transfers but posited on then realistic price expectations for sugar exports to the EU market) have already been secured to make the necessary investments. On the other hand, delaying reform of the COMS is unsustainable given the pressures for reform and the widespread global view that the COMS distorts international trade and is developmentally wrong because it adversely affects those producing-countries (often poorer than in the Caribbean) which do not benefit from the preferential arrangement.

Box 1: View of Caribbean producers and policymakers

Concerns have been expressed in some quarters of the ACP that to discuss the issue of *ex post* 'compensation' publicly could be interpreted as accepting proposals for reform: a concept that some Caribbean countries consider politically unacceptable. Their current tactics are to use lobbying within EU countries to delay any changes and/or to increase the 'price' of their acceptance of the need for change. The Directors of the Sugar Association of the Caribbean (SAC, 2004) 'are convinced that the ACP can secure a better deal' and are 'in favour of involving the regional diaspora in the UK in ensuring public opinion is behind Caribbean sugar'. They are also trying to underplay the ability of Latin American producers to benefit from better access. As these tactics have had some effect, including the delayed implementation of the sugar reforms and support by UK MPs (Early Day Motion on sugar, 14 December 2004) and some EU Members (Spain, Italy) for further delays they are unlikely to abandon them in the near future. This will make it difficult for them to have a public input into the design of transitional assistance so the UK and EU will therefore need to find ways of maintaining some dialogue.

Quota reallocation

Preferential tariff quotas could be redistributed from those countries that have already diversified production and are willing to forfeit them to other countries in the group. This could increase the quota allocation of some countries which would offset some of the losses from a fall in the EU price. It is, however, unlikely that any of the ACP Sugar Protocol countries would be willing to do this unless their quota allocation is small (and, therefore, the income transfers less significant to potential recipients). Barbados, for example, has an annual quota of 50,312 tonnes under the Sugar Protocol (see Table 7) but sugar production has declined due to increasing labour and land costs. Although domestic consumption of sugar relies heavily on imports and the country has failed to fill its SPS quota in recent years, it would be unlikely to give up its Sugar Protocol quota allocation since all of it high-cost output is shipped to the EU under this.

Alternative market access

Improved market access for other products, especially services (tourism and mode 4) could encourage diversification into more profitable activities. Expansion of the services sector in the Windward Islands has already offset the losses arising from the decline of their banana sectors (see Section 4.1.1). In services, the provision of preferential access might be more acceptable to the EU than multilateral liberalisation. However, this approach would need to be seen as purely a transitional measure since economic development requires constant diversification and cannot be based on any single export. It may also be difficult for ACP Protocol countries to negotiate new preferences. CARICOM and the African regions are already pursuing a liberalisation agenda, including demands for access to services markets, in the context of EPAs. They might be unwilling to treat any gains in EPA negotiations as compensation to the (in principle separate) losses on sugar.

5.3.2 Financial instruments

Financial transitional assistance measures have direct budgetary implications but, crucially, do not suffer from the threat of future preference erosion and, unlike trade measures, they do not impose costs of protection on EU consumers.

Transitional assistance can offer support at the national, firm or household levels (or some combination) with varying conditions of use attached.

For countries where there remains a viable future for sugar production under reduced tariff preferences, two options for transitional assistance present themselves to improve the competitiveness of the sector.

First, support could be provided to increase the competitiveness of bulk commodity production. At the national level, this could consist of investment in public goods such as research and infrastructure, branding and marketing. Research could be targeted on field productivity improvements (e.g. improved irrigation) and infrastructure investment could reduce transport costs. At the firm level, assistance for industry restructuring could be provided to assist with the scaling back of production to focus on output in low-cost areas, modernisation of mills and closure of inefficient facilities. The Belize sugar industry, for example, in its current form could remain viable under reform of the COMS (costs are around 12-13 US cents per pound) but this conclusion is marginal and an improvement in the competitive position of the industry would be needed in order to enable it to survive the impact of preference erosion. In particular, efforts to reduce the high transport costs associated with moving sugar to the port could allow Belize to compete under the conditions of a liberalised EU market. Guyana is also well-placed to compete under a reformed COMS because of its low costs of production (about 17-22 US cents per pound) and its access to regional markets which is expected to grow as other Caribbean sugar-producing countries cease production.[25] Guyana has also established a long-term plan for the modernisation of its sugar industry which remains at an early stage of development. The crucial factor within this is labour costs (reducing wages and providing redundancy payments) and potential opposition from the strong trade unions. The National Development Strategy in Guyana opened up the question of closing the most unproductive estates (in Demerara) in order to focus modernisation efforts on those exhibiting greater productivity (e.g. the Skeldon factory) in regions where cultivation conditions are better suited (in Berbice). This will probably take place in 2006 although, in the meantime, Demerara factories have begun efforts to reduce efforts to reduce labour costs, improve productivity and diversify their product range but with no certainty that they can avert the likelihood of closure.

[25] In 2002, 28 percent of Guyana's sugar exports went to CARICOM compared to 19 percent of its total merchandise exports.

Second, another option at the firm level would be to diversify out of bulk sugar exports into sugar-related or speciality (e.g. bagged and branded) products in higher-priced markets. If successful this could help to compensate for the reduction in income from bulk sugar sales to the EU market. Guyana, for example, is proposing to diversify into ethanol production (from cane juice and molasses) and electricity generation (from bagasse). Co-generation is seen as viable since offsetting oil costs could save substantial foreign exchange. For ethanol, Guyana has preferential access to the US market under the CBI Initiative and there have also been negotiations with Trinidad and Tobago. Ethanol produced in Guyana could be combined with oil to produce (environmentally-friendly) fuel. There are, however, a number of potential obstacles to this approach. For ethanol, production requires significant capital investment in facilities for distilling and there must also be large surpluses of molasses available at low cost (the distillery may have to compete with demand for molasses from the domestic feed and rum industries) to benefit from economies of scale on the required capital investments. This is particularly problematic given the large distilling capacity of competitors on the world market. Brazil, in particular, is also planning to increase the share of its sugar production going into ethanol and has advantages of experience and scale (Bridges, 2004). For electricity, there must be sufficient domestic demand to justify the high investment cost of co-generation capacity.

An alternative way of adding value to sugar is the development of organic or Fair Trade products, where there is demand and price is not the sole criterion for purchase. For bananas, some success has already been shown with Fair Trade exports from the Windward Islands (see Box 2).

However, the success of niche marketing strategies depends greatly on the price premium received, the level of tariff and the number of competitors in niche markets. For sugar, twelve producer organisations in six countries (Malawi, Ecuador, Paraguay, Peru, Costa Rica and the Philippines) are Fair Trade certified. Global consumption for Fair Trade sugar was only 1,164 tonnes in 2003 and most of this was used for producing Fair Trade chocolates and does not represent direct sugar consumption. In addition, a large part is a combination of Fair Trade and organic sugar (for which Paraguay is the main supplier). The price for refined Fair Trade Sugar is US$520/tonne compared to a world market price level of US$220-240/tonne. Organic Fair Trade sugar attracts an additional premium of US$120/tonne (Gerster and Jenni, 2003).

Box 2: Fair Trade and organic bananas

Fair Trade organisations have created a parallel marketing chain that allows consumers to pay a premium that directly supports agricultural producers. This constitutes a different approach to marketing, in that buyers are informed and concerned about the nature of production, not only about the quality and other characteristics of the product (Page, 2003).

Fair Trade bananas first appeared in the Netherlands in 1996 and within a few months had captured 10 percent of its banana market (Myers, 2004). They were subsequently marketed in Switzerland (accounting for 37 percent of Fair Trade banana sales in 2003), the UK (36 percent) and Finland (5 percent). In the UK, Fair Trade bananas rose from 1 percent of banana sales in 2000 to 3 percent by 2003. Evidence from the Netherlands and Germany suggests that following an initial enthusiasm sales tend to decline (FAO, 2001) but forecasts for the proportion of Fair Trade bananas in total banana sales in the UK market, by 2006, vary from 5 percent to 10 percent (Bretman, 2003). In 2000 the Windward Islands started to export Fair Trade bananas to the UK. Today, the Windward Islands supply 54 percent of Fair Trade bananas sold in the UK market, followed by the Dominican Republic (21 percent). Nevertheless, the potential for Fair Trade bananas from the Caribbean is limited since they could only provide an outlet for a fraction of total output. Much will depend on the sales policy of the major supermarkets and how far Fair Trade products are promoted.

The production of organic bananas also represents a potentially attractive means of assisting poor producers, since the poorest farmers are the least able to acquire chemical fertilisers and sprays. However, in practice the processing and marketing of these commodities is more difficult and complex than for those produced traditionally. In particular, the system requires that the commodity be traceable from its source through the value chain. This requires comprehensive inspection and certification, which is much easier for large plantations than for scattered smallholders. In addition, conversion to organic banana production takes, typically, three years. During this period products do not earn a price premium even though (higher cost and lower yield) organic methods must be used.

In 2000 the UK became the largest market in the EU for organic bananas: organic bananas accounting for 5 percent of the UK market compared to 1 percent in the EU as a whole. The Dominican Republic has led the development of organic banana exports and in 2001 provided over half of global supply. A number of Latin American countries also export them. In 2002, Tesco encouraged Grenada to dedicate land to a range of organic fruit and vegetables, including bananas.

While it remains to be seen whether Fair Trade agricultural products can secure a significant share of the conventional market for any particular commodity, there are questions in any case about the long-term effectiveness of such a solution on a large scale. Sceptics argue that Fair Trade arrangements are analogous to a voluntary tax or charitable contribution paid by developed country consumers. They question the potential for helping a large number of poor producers in this way because of the correspondingly large number of consumers required to contribute.

For high-cost countries where sugar production will not be possible after the reduction in EU prices, diversifying into other activities is essential. The main benefits of diversification away from bulk sugar production (which also applies to primary commodities in general) are reduced risk and more stable export revenues. Topographical characteristics of many of the small Caribbean islands make it unlikely that

diversification into other agricultural products is a viable option, except to supply the domestic market. Many crops such as mangos, pineapple and citrus would also face either significant competition in the major markets or highly restrictive trade barriers. Among the ACP Sugar Protocol signatories, Mauritius has shown great success in using the economic rents associated with preferences to secure long-term efficiency gains by diversifying into new export sectors (see Box 3).

Box 3: The case of Mauritius

Sugar companies in Mauritius have succeeded in diversifying into new areas of production. Until 1975, sugar production in Mauritius grew steadily to meet rising demand in the EU (guaranteed) market which was also associated with rapid price increases. In subsequent years sugar prices started to fall and the viability of the industry was threatened. This was aggravated by an increase in the sugar export tax in 1979 coupled with hurricanes and drought. The Government, in consultation with the private sector, developed a Sugar Action Plan which provided for export duty relief, restructuring the industry at a national scale (two small mills were closed in 1985) and modernising the practises of both cane growers and mills. Further reforms occurred in 1988 under the Sugar Industry Efficiency Act, the objectives of which were to provide for an efficient and viable sugar industry while seeking to promote diversification both within and outside sugar. The Act reduced the nominal export duty rate and a system of performance-linked export duty rebate was introduced whereby incentives were provided for improved efficiency, enhanced use of bagasse for electricity production and use of marginal cane land for the production of crops other than sugar. Changes to income tax also provided incentives to produce speciality sugars, to limit energy use in cane processing and to use bagasse for co-generation. This was followed in 2001 by the Sugar Sector Strategic Plan which included measures designed to streamline the sugar industry by ceasing production in outdated sugar refineries, increasing the production of electric power from bagasse, converting land for alternative uses including tourism and information technology, and (uniquely) reducing labour in the sector by establishing a voluntary retirement scheme for cane growers and workers in sugar refineries.

Sugar production in Barbados has also declined as labour and land costs have increased, driven by the growth of its services sectors (tourism and financial services). Although sugar remains important to the country's history and employs half of the agricultural labour force it would not be impossible for the new high-growth sectors to absorb sugar labour over time. Given the large tourism industry (accounting for over 15 percent of GDP and three-quarters of foreign exchange receipts) branded, bagged and speciality sugars may be viable on the domestic market although it is unlikely that the sugar sector could ever again compete globally on cost.

Many of the other Caribbean ACP countries have been steadily diversifying their economies, based on an inflow of foreign investment and increased exports of services. The Windward Islands, for example, have already shown some success in diversifying away from banana production into tourism, banking and insurance. Another example is Jamaica which although facing serious economic problems, including the weakness in its financial market, speculation, and low levels of confidence in its productive sectors, has witnessed investment by foreign firms in textiles (garment assembly), light manufacturing, and data entry services. Jamaica is also exploring diversification

opportunities into the production of sea-island cotton and the development of off-shore retirement homes and medical centres for US clients.

However, diversification is problematic for commodity-dependent developing countries. In particular, the ability of small island developing states to diversify into new sectors could be hampered by a combination of factors specific to them: vulnerability to natural disasters (sugar is recognised as being the most hurricane-resistant crop); small internal markets; high operating and transport costs (because of small scale and distance from suppliers and markets). This means that while they still have a comparative advantage in some sectors, some argue that they may never be able to secure an adequate income (Winters and Martins 2004). Moreover, as in niche sugar products, already established players may provide fierce competition and banking systems and capital markets in many ACP countries are underdeveloped, making it difficult for new producers to raise the necessary capital for investment (Page and Hewitt, 2001).

There are 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 banana- and sugar-producing countries, but this would require the EU to demonstrate unprecedented political willingness to allow increased imports of foreign labour. It could also result in the transformation of some Caribbean countries to migrant economies (Page and Kleen, 2004).

Transitional assistance could play a key role in supporting any of these diversification strategies by funding investments and promoting retraining. Donors, however, are not in the best position to 'pick winners' in identifying potential growth opportunities that deserve funding. Choices are better made by national recipient governments or by the private sector, as happened in Mauritius.

At the household level, it is difficult to devise a general mechanism for providing transitional assistance to the poor. Assessing the impact of preference erosion arising from reforms in the EU's banana and sugar markets on poor people requires a good understanding of the various ways in which households are involved in trade before devising transitional assistance mechanisms aimed at helping them. The net effect of preference erosion can only be grasped by considering the multiplicity of activities in which households and individuals are engaged as consumers, income earners and producers. If diversification is the objective, specific measures to reduce the negative consequences of preference erosion on poor households may be desirable in the short run, but should not make banana or sugar production more attractive in the long run. Support for transitional assistance at the household level should be targeted at increasing the capacity of the poor to respond to change. This involves assessing how the combination of assets they use in producing agricultural or manufactured goods or services – natural, social, human, physical and financial capital – can be positively altered to allow them to respond to the preference erosion shock. Support to enhance and diversify assets and increase productivity and value-added could include access to finance, rural credit facilities, provision of extension services and training. In addition, improving health and

education and infrastructure (such as transport and communications) can enable new sectors to emerge and increase productivity.

5.4 Channels for transitional assistance

Having discussed the various ways in which transitional assistance could be used, we now turn to discuss the various channels through which this support could be provided: through the private sector, national governments, regional organisations (e.g. CARICOM) or multilaterally (e.g. WTO). However it is provided, support for transitional assistance should be de-linked from production of the declining commodity in order to avoid funding failure.

Direct support to the private sector has proved controversial under, for example, the EU's Rum Programme. In particular, support risks being used as a subsidy to increase company profits (without directly helping the employees), offsetting incentives for diversification and crowding out private investment. It is however the method to be used for EU sugar producers and where diversified companies exist, as in Mauritius, it could be a successful way of funding diversification.

National governments may be in the best position to decide on and implement strategies for improving competitiveness and diversification. Financing for transitional assistance could be provided to them via general budget support or specific investments to support projects focusing on the production of sugar or alternative crops and sectors. The latter would imply greater donor involvement in supervision and management of funding and could lead to *ad hoc* and uncoordinated investments which have tended to characterise project aid in the past. The former, in contrast, would allow support for broad-ranging and multi-sectoral strategies which could also be integrated with the priorities of each government. Either, as noted above, could be implemented well or badly, and experience with the SFA suggests that both donor and Caribbean governments will need to find more effective strategies than in the past. A potential concern for the EU would be that resources for transitional assistance would not be used for their intended purposes. Conditionality could be imposed to correct for this but could cause a number of problems. First, conditions of use would complicate the operation of the scheme potentially limiting its flexibility and delaying disbursements. Second, conditionality would be inconsistent with the fact that no constraints were ever imposed on how income transfers from the Sugar Protocol were to be spent by the ACP sugar-producing countries that received them.

In addition to channelling transitional assistance through national governments, assistance to regional organisations could also contribute to the restructuring of the sugar industry and diversification into more productive sectors. The creation of regional research programmes and marketing organisations could benefit from economies of scale providing cost advantages. Strong regional groups, such as CARICOM, which are both

cohesive and well-coordinated may also be well-positioned to determine inter-country allocations of funds (see Section 5.5).

Alternatively, financing could be given to a multilateral organisation which would then administer it to individual recipients. This would provide the necessary mechanism of legal commitment or 'binding' which purely donor-directed funds lack. The fund could be administered by the WTO but this would be inconsistent with its role as a regulatory body (lacking competence in providing financial assistance) compared to donors and international financial institutions. On the other hand, asking agencies (such as the World Bank and IMF) to administer the fund could conflict with these institutions' priorities which have been firmly established. Another possibility would be the Common Fund for Commodities (CFC) which was initially envisaged as an instrument to fund buffer stocks of core commodities but now undertakes technical assistance pilot projects in developing countries (focusing on individual commodities) and multi-country projects examining market chain strategies.

For sugar, however, it is unlikely that a multilateral solution could be found in the timeframe available. As such, a bilateral arrangement between the European Commission (and its Member States) and the ACP is a more realistic prospect. This, however, would need to be regulated by a legally binding treaty for it to be acceptable as an alternative to the existing legal force of the Sugar Protocol.

5.5 Duration of support and country allocation criteria

Two crucial decisions that must be taken in any scheme for transitional assistance concern individual country allocations and the length of the transition period (duration of support).

Individual country allocations should be fixed since this offers predictability for the recipient governments and their private sectors. There is no justification to link country allocations to traditional aid criteria (e.g. level of income, incidence of poverty) since transitional assistance is a not a normal aid instrument that is aimed at poverty reduction but a trade instrument designed to facilitate adjustment following a preference erosion shock. As such, country allocations should be clearly linked to the loss in income transfers arising from preference erosion since this measure is objective, simple and easily measurable in advance without the need for complex modelling (which could be contested). This would have a clearer link to the problem being faced than competitiveness gap measures (as used under the SFA).

In terms of the duration of support, there are arguments that preference erosion is permanent, in contrast to temporary balance of payments shocks (like those for commodity price volatility or natural disasters), and that permanent differences in the structure of some economies (vulnerability, smallness, remoteness) serve to raise the costs of production (and trading), obstruct the reallocation of resources into new sectors

and reduce the number of diversification opportunities. However, transitional assistance should be time bound since trade policy is not permanent and cannot be treated as such. Expectations will adjust following the reduction of preferences and economies will restructure.

An adjustment period will need to be negotiated but a reasonable estimate is 10 years, with transitional support declining in a pre-determined and predictable way.[26] Whatever the duration of support chosen, some countries will be able to adjust more quickly than others. Funding should be front-loaded and most of the funds should be disbursed in advance of changes to the COMS in order that countries are provided with sufficient time to invest. The degree of front-loading will depend on the total funding available for the duration of transitional assistance: smaller levels of financing would dictate high levels of support in the first few years only which would decline rapidly thereafter.

5.6 Sources of Funding

Assuming a high liberalisation scenario the initial annual cost of transitional assistance to offset the reduction in income transfers would be of the order US$500 million for sugar and US$100 million for bananas (additional to the SFA which was designed to compensate for the 1998 reforms to the COMB). These are relatively small sums compared with, say, STABEX which had a budget of €4.4 billion but projected losses for some ACP countries arising from reform of the EU's Sugar and Banana Regimes (see Table 30) are high relative to their external income (see Table 31). Countries that stand to lose large amounts are in a more vulnerable position: the most significant losses relative to external income are for St. Vincent (bananas), Guyana (sugar), Dominica (bananas) and Belize (bananas and sugar).

The most appropriate source should have simple procedural rules (in order to secure rapid disbursement and flexibility in use) and be additional to existing aid allocations (not be financed by reallocating funds). This is both because the need is new and additional (the result of a trade policy change, not development needs) and because the allocation among countries must be different. This suggests that the plan for assistance to fall under the existing EDF allocations for 2006 to 2013 should be reconsidered.

There two main instruments of EU funding available: National Indicative Programmes funded by the EDF and European Investment Bank loans. A number of new measures have also been proposed such as a consumer levy on sugar and the creation of a dedicated budget line (outside the EDF) for preference erosion.

[26] The MFA, for example, gave textile and clothing industries 10 years for adjustment, although the continuing demand for assistance to meet preference erosion at the end of the period (end-2004) and the decision by the IMF to give TIM aid to Bangladesh suggest that some believe this was not enough.

Table 30: Change in income transfers from reform of EU Sugar and Banana Regimes

	Change in EU income transfer from: (US$ 1000s)					
	Partial liberalisation of Sugar Regime 1/	Full liberalisation of Sugar Regime 2/	High tariff-only Banana Regime 3/	Low tariff-only Banana Regime 4/	Low liberalisation (1+3)	High liberalisation (2+4)
Africa						
Congo Republic	-73	-733			-73	-733
Côte d'Ivoire	-368	-3,716			-368	-3,716
Kenya	-134	-1,354			-134	-1,354
Madagascar	-557	-5,621			-557	-5,621
Malawi	-1,382	-13,954			-1,382	-13,954
Mauritius	-20,361	-205,611			-20,361	-205,611
Swaziland	-6,352	-64,143			-6,352	-64,143
Tanzania	-499	-5,040			-499	-5,040
Uganda	0	0			0	0
Zambia	-545	-5,501			-545	-5,501
Zimbabwe	-2,245	-22,666			-2,245	-22,666
Caribbean						
Barbados	-1,822	-18,398			-1,822	-18,398
Belize	-1,666	-16,819	-6,832	-15,860	-8,498	-32,679
Dominica			-14,640	-14,640	-14,640	-14,640
Guyana	-6,863	-69,301			-6,863	-69,301
Jamaica	-5,227	-52,784	-14,884	-27,694	-20,111	-80,478
St. Lucia			-16,226	-30,500	-16,226	-30,500
St. Kitts	0	0			0	0
St. Vincent			-16,226	-21,960	-16,226	-21,960
Suriname	0	0			0	0
Trinidad Tobago	-1,652	-16,687			-1,652	-16,687
Pacific						
Fiji	-5,498	-55,523			-5,498	-55,523

Table 31: Change in income transfers as a percentage of external income

	US$1000	Change in EU income transfer from: (% of external income)					
	Average 1999/2002 external income 5/	Partial liberalisation of Sugar Regime 1/	Full liberalisation of Sugar Regime 2/	High tariff-only Banana Regime 3/	Low tariff-only Banana Regime 4/	Low liberalisation (1+3)	High liberalisation (2+4)
Africa							
Congo Republic	2,471,450	0%	0%			0%	0%
Côte d'Ivoire	5,502,075	0%	0%			0%	0%
Kenya	3,498,075	0%	0%			0%	0%
Madagascar	1,440,503	0%	0%			0%	0%
Malawi	939,418	0%	1%			0%	1%
Mauritius	2,864,500	1%	7%			1%	7%
Swaziland	1,132,350	1%	6%			1%	6%
Tanzania	2,600,400	0%	0%			0%	0%
Uganda	1,502,038	0%	0%			0%	0%
Zambia	1,618,053	0%	0%			0%	0%
Zimbabwe	2,401,025	0%	1%			0%	1%
Caribbean							
Barbados	1,331,025	0%	1%			0%	1%
Belize	474,808	0%	4%	1%	3%	2%	7%
Dominica	161,653			9%	9%	9%	9%
Guyana	800,570	1%	9%			1%	9%
Jamaica	3,320,900	0%	2%	0%	1%	1%	2%
St. Lucia	407,023			4%	7%	4%	7%
St. Kitts	169,105	0%	0%			0%	0%
St. Vincent	189,418			9%	12%	9%	12%
Suriname	230,153	0%	0%			0%	0%
Trinidad Tobago	4,416,475	0%	0%			0%	0%
Pacific							
Fiji	1,141,142	0%	-%			0%	5%

1/ Compliance with the recent WTO ruling - reduced subsidised exports by 68.8 percent (2.8 million tonnes) – simulation 1, see Appendix 17 and Section 4.2.2.
2/ Full OECD liberalisation) – simulation 4, see Appendix 17 and Section 4.2.2.
3/ Tariff of €200/tonne – see Table 25. €1 = US$1.22.
4/ Tariff of €125/tonne – see Table 25. €1 = US$1.22.
5/ Gross ODA (all donors) + total exports of goods & services.

Source: Calculated using Milner *et al.* (2003); NERA/OPM (2004), World Bank (2004b); OECD (2004).

5.6.1 National Indicative Programmes

The main form of EU development assistance is the A envelope of National Indicative Programmes (NIP). This provides resources for general (five year) development programmes that are planned on the basis of a country strategy. The A envelope of NIP covers programmed development activities, and the B envelope covers contingencies including the FLEX instrument (NERA/OPM, 2004).

The EU Action Plan envisages that transitional assistance programmes for the ACP Sugar Protocol signatories, to increase competitiveness or assist in diversification in response to the lower guaranteed price, will fall under the existing EU budget from 2006 to 2013. The financing of such measures will be ensured through a contingency fund (the flexibility instrument) up until the end of 2006 which is financed from the EDF, and then by an appropriation within the Development Cooperation and Economic Cooperation Instrument between 2007 and 2013.

The main advantage of using EDF financing for transitional assistance is that it would make use of an existing budgetary instrument. However, both STABEX / FLEX and NIPs are provided under the EDF with all ACP countries having an aid entitlement under the latter. It is unlikely that the ACP Sugar Protocol countries would forego their Sugar Protocol benefits in exchange for EDF funding because they would not be convinced that the amounts would be additional. Therefore, a transitional adjustment increase funded outside the EDF and additional to it is necessary.

5.6.2 European Investment Bank Funding

Under the Cotonou Agreement the European Investment Bank (EIB) provides lending to projects, alongside grant aid from the Commission. The EIB, an autonomous organisation, was founded in 1958 and has been lending outside the member states since 1962. Total lending to ACP (and the EU's overseas territories) between 1997 and 2001 was €1.9 billion, which amounted to 17 percent of total external lending and 10 percent of total lending. In the period to 2008, the EIB is expected to lend €3.9 billion to ACP projects (Commonwealth Secretariat, 2004). The main instruments are loans and equity financing. Most loans are provided using the EIB's own resources while some are also financed by so-called risk capital – funds allocated by the EDF. Loans are long-term (up to 25 years), require government guarantees, usually finance up to 50 percent of the total project cost and often fall between €1.5 million and €25 million.

The use of EIB loans to finance transitional assistance measures in the ACP Protocol countries would be problematic. First, already highly indebted countries may not be well-positioned to take out additional loans. Second, EIB lending has been criticised for not favouring small firms (often argued in the Caribbean) which have experienced difficulties in obtaining EIB loans directly (te Velde and Bilal, 2003). Third, lending on favourable

interest rate terms has not contributed effectively and efficiently to investment because the use of funds has not been adequately monitored (EIB, 2002).

5.6.3 Tariff and consumer levies

For bananas, the proposed tariff under the regime to be implemented in 2006 could generate sufficient revenue in the EU budget for financing direct aid to suppliers in the ACP and overseas territories. The concept of hypothecating revenue from a tariff has long been advocated (Fitzpatrick, 1990; Borrell and Cuthbertson, 1991; Matthews, 1992). However, the chosen level of tariff is far above that which would have sufficed to generate the extra budget revenue that the EU may need to finance transitional assistance measures for banana-producing ACP countries and overseas territories: a specific tariff of around €125/tonne would have been sufficient to raise the necessary revenue (Tangermann and Verissimo ,1999).

Proposals have also been made for introducing a sugar tax to fund transitional assistance measures in the Sugar Protocol ACP countries. A levy of €25/tonne (representing 3 percent of the current price) would raise €400 million. Processors would pay the levy and pass it on to consumers.

5.6.4 A dedicated budget line for preference erosion

Given the problems associated with these funding options there may be a need to develop a dedicated budget line for transitional assistance to the ACP Protocol countries. This would send a clear message that additional resources are being made available to address adjustment costs arising from preference erosion. However, it may be difficult to raise additional resources. The current EU financial perspective which sets the EU budget operates until the end of 2006. It is therefore unlikely that any additional funds from the EU budget could be made available until 2007. Transitional assistance could not be directly financed from cost savings to the CAP (arising from reform of the COMS) since these would accrue to consumers and not the EU budget (see Section 3.2). In theory, an increase in VAT that raised equivalent revenue would keep unchanged fiscal demand in the EU and be available to fund transitional assistance.

6. 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.

Following reform of the EU's sugar and banana markets due to begin after 2005, preferential access will be reduced which, while benefiting major non-Protocol producing countries (often poorer than the Caribbean), will necessitate further diversification in the higher-cost Protocol countries. Nevertheless, there may be a future for continued production and export in the most competitive Caribbean ACP countries - Belize and Guyana (for sugar); Belize and Jamaica (for bananas) - although for the Windward Islands this will depend crucially upon whether the (high) single tariff that the EU has proposed of €230/tonne for bananas will be acceptable to the US and Latin American suppliers, as they may decide to contest this in the WTO. In the unlikely event that a high tariff can be successfully negotiated, then this may be sufficient to maintain their share of the EU banana market. Nevertheless, financial solutions, which do not suffer from the threat of preference erosion, must be found to facilitate adjustment in adversely affected sugar countries even if some banana producers can postpone adjustment.

Total losses for ACP Protocol countries have been estimated to be in the region of US$500 million for sugar and US$100 million for bananas. Although the arguments for providing transitional assistance on developmental grounds are weak for the Caribbean – none of the ACP Protocol countries in the region is classified as Least Developed - assistance can be justified (in the case of sugar) under the EU's international obligations because it is partially withdrawing from a binding undertaking which was of unlimited duration. In its absence, countries that stand to see a reduction in their income transfers may attempt to obstruct reform to the detriment of those countries which stand to gain.

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. Funding for diversification purposes has generally failed to stimulate the development of more productive sectors due to the frequent use of unrelated small-scale pilot projects that ignore the wider constraints in the economy. Future support, possibly through the creation of a new and dedicated preference erosion fund, 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 it 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 e.g. ethanol production.

For sugar, and at the country-level, Belize and Guyana are the most competitive sugar producers internationally among the Caribbean ACP producers and their strategies to improve the competitiveness of their sugar industries could merit financial support from abroad. The viability of Jamaica's sugar sector is much more fragile, and its investment plans more difficult to realise, while Barbados and St. Kitts have largely diversified out of sugar, although the former has reasons connected with its tourist industry for not discontinuing production for export altogether.

For bananas, diversification into services in each of the four Windward Islands has already more than compensated for declines in banana production arising from existing reforms made to the EU's Banana Regime. Financial support could be provided to continue this trend.

Transitional assistance, allocated in proportion to each country's loss of income transfers arising from preference erosion, should be channelled through national governments or, where there are potential economies of scale or the willingness of a set of countries to decide on intra-group allocations of funding, via regional organisations. Providing support directly to the private sector would risk crowding out investment and could offset incentives for diversification. As a longer-term objective, however, the creation of a multilateral scheme dedicated to preference erosion, encompassing all countries and all sectors, would help to mitigate future problems in other sectors (e.g. for textiles) and facilitate agreement in the WTO.

Finally, funding for financial assistance would need to be additional to existing aid allocations in order to send an important political message to ACP Protocol countries that the EU is committed to facilitating adjustment in their economies. Therefore, allocations should not come from the EDF but from the creation of a dedicated line in the EU's budget developed for this purpose. The level of funding allocated would dictate the duration of support and its degree of front-loading.

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