



EUROPEAN COMMISSION
DIRECTORATE-GENERAL FOR AGRICULTURE AND RURAL DEVELOPMENT

Directorate E. Economic analysis, perspectives and evaluation; communication
Director

Brussels, **28 MARS 2014**
DDG2.E.1/BT/iv D(2014) 993738

NOTE TO THE ATTENTION OF MESSRS.

[REDACTED] DIRECTOR

[REDACTED], DIRECTOR

Subject: **Assessment of main results presented in the IPTS study 'EU sugar policy: A sweet transition after 2015?'**

Please find attached a note presenting the background and main results of a recently published JRC-IPTS report entitled 'EU sugar policy: A sweet transition after 2015?'.

The JRC report was delayed at AGRI's request in order not to interfere with the CAP reform negotiations. The Note presents our assessment of the results of the JRC report on the basis of an earlier impact assessment carried out in DG AGRI (Ares(2013)299795). It is intended to serve as a background for concerned AGRI units in interpreting the IPTS results and in helping to respond to eventual questions by stakeholders.

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Directorate E. Economic analysis, perspectives and evaluations; communication
E.1. Agricultural policy analysis and perspectives

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NOTE FOR THE FILE

Note on the IPTS report "EU sugar policy: A sweet transition after 2015?"

This note presents the background and main results of the recently published JRC-IPTS report on the impact of abolishing sugar quotas, as well as our assessment of the results on the basis of a DG AGRI analysis (Ares(2013)299795) that was finalised in March 2013. While the report provides a very useful overview of the theoretical framework regarding the quota system and contributes to the literature on possible outcomes at Member State level, a number of limitations of the modelling tool and approach warrant a very careful interpretation of the results, particularly on the potential for isoglucose market penetration and on the impact on EBA/EPA exporters. It can be expected that the impact on EBA/EPA exports will be used by concerned stakeholders to argue for a possible re-consideration of quota abolition in the context of policy coherence for development.

Background

The IPTS report was commissioned by DG AGRI at the beginning of 2012 as part of a supplementary analysis on the implications of sugar quota abolition addressing various issues that were not covered in depth in the impact assessment accompanying the legal proposals on the CAP post-2013. The objective was to provide an analysis of the implications at Member State level and of the potential impact of the removal of isoglucose quotas. The report was originally due for publication by mid-2012, together with an updated scenario analysis by DG AGRI that was to broaden the impact assessment on EBA/EPA exporters and sensitivity analyses on various external drivers. However, difficulties regarding the modelling of the sugar market in the CAPRI model used to carry out the simulations led to a considerable delay in the finalisation of the results, and given that important caveats remained regarding results, it was decided to delay the publication of the IPTS report until these results were clarified. This influenced the fate of the DG AGRI analysis, whose publication was put on hold as well.

Main results of the IPTS report

The report compares two scenarios; one assuming the expiry of EU sugar quotas in 2015/16 and the other assuming the continuation of the current sugar quota scheme. This is complemented by a sensitivity analysis on two alternative assumptions regarding the share of isoglucose on the sweetener market. The year of comparison is 2020, i.e. five years into the post quota situation. The main findings and our evaluation of the results are presented hereunder. The percentage changes refer to the difference in values between the quota and no quota scenarios.

- EU **production** of sugar beet and white sugar increases by around 4%, driven by larger sugar beet areas, with a marginal but positive impact on the production of cereals.

The magnitude of change is near to the AGRI simulation results of +6% for beet and +7% for white sugar, also driven by increased land use for sugar beet, but in our case this leads to a decline in cereal production. Our slightly higher impact for white sugar is explained by the switch from ethanol to sweetener use after quota abolition as a consequence of the increase in the previous 'out of quota' sugar price.

- The average EU beet **price** declines by 15-16%.

The AGRI analysis depicts a less severe (5%) fall in the beet price but a more pronounced (19%) drop in the white sugar price for the post-quota market equilibrium. The sharp decline in the white sugar price is not fully transmitted to beet producers as beet prices fall less due to the convergence of previously high 'in-quota' and low 'out-of-quota' prices, with the growth in the latter partially offsetting the drop in the former.

- EU human **consumption** of sugar increases marginally, while the importance of sugar as an ethanol feedstock declines by a few percentage points.

The outcome on ethanol use corresponds to our own results but we project a slightly lower sugar use for human consumption. This however could stem from a difference in the assumed market share of isoglucose, as under both AGRI and IPTS simulations total sweetener use increases and sugar use declines with a higher isoglucose demand.

- On **trade**: EU sugar exports fall by 16%, while raw sugar imports decline by 43% and mainly from EBA/EPA exporters (-53%), with but a slight (4%) decrease from Brazil.

Here there are strong differences. Firstly, we project an increase in EU exports (+11%), as the convergence with world prices improves the competitiveness of EU exports. Secondly, while the decline in EU imports is very similar (-41%), it is less pronounced for EBA/EPA (-39%) given their preferential access compared to other exporters facing tariffs. Given that **these results could have considerable implications with regard to policy coherence for development**, a more thorough assessment is provided hereunder based on section 1.4 of the attached note.

While the IPTS report does not include a thorough analysis of the external impact of sugar quota abolition it does suggest a considerable welfare loss for EBA/EPA exporters. According to our analysis, not only is the decline in exports to the EU less severe, but the firm global demand as projected in our own simulations - based on the 2012 OECD-FAO outlook - also allows EBA/EPA exports to be diverted to other destinations, dampening the potential welfare loss.

The lack of reporting on simulated prices makes it difficult to qualify the IPTS results. Nevertheless, it is understood that results are driven by a modelling approach whereby TRQs on imports from Brazil are assumed to be filled under each scenario irrespective of the relationship between the EU and world prices. As the available results suggest a strong convergence between these prices, we expect the EUR 98 per tonne tariff on imports from Brazil to divert trade to other exporters. Therefore we consider that the implications for imports from EBA/EPA countries are exaggerated on aggregate. However, based on our current understanding, we acknowledge that the impact could remain severe for certain, less competitive EBA/EPA exporters.

- There is a very small positive *welfare* change, although income accruing to sugar beet producers falls by over 17% and average revenue per hectare by 5.8%, whereas consumers are likely to gain.

The modest overall welfare gain is in line with our analysis, but according to our results **beet growers could be less affected**, as the decline in revenues from beet production are counterbalanced by an increase in revenues from arable crops as prices for cereals and oilseeds increase in the wake of growing competition for harvested areas. At the same time there is a **strong negative impact on white sugar producers and especially raw sugar refiners**, implying that the refining sector will have to undergo considerable restructuring to remain economically viable under a no quota scenario. Furthermore, we find that final consumers will benefit to the extent that the price decline will be transmitted along the supply chain by intermediate consumers.

- While *impacts at Member State level* are not uniform, all Member States except Greece and the Netherlands increase sugar beet production.

Results from other external impact assessments and expectations based on economic theory warrant a **careful interpretation of these results**. Experience from the 2005 sugar reform suggests that quota abolition could lead to further concentration towards the more competitive regions for beet production, mainly the countries of the beet belt (i.e. BE, DE, FR, NL, PL and UK), which is supported by quantitative analysis from other external sources (section 1.2 of the attached note presents the range of outcomes across Member States from three recent studies, including those from the IPTS report).

The methodology behind the IPTS results has admittedly strong caveats regarding considerations for the potential growth for isoglucose production, but also seems to contradict existing competitive advantages that are outlined in the report itself. Nor does the approach incorporate potential processing capacities in light of expected price developments. It is vital to factor in such considerations, as for example LMC International considers that most Member States already operate at full sugar processing capacities with limited potential to increase production or expand capacities in light of the projected price decline following quota abolition. In this case production growth could be limited to Member States with existing spare capacities, such as CZ, HU, LT, SK (i.e. countries outside of the beet belt) and FR.

- The aforementioned impacts become more severe with a *higher market share for isoglucose* both at EU and at Member State levels.

This is confirmed by our own sensitivity analysis assuming a higher level of isoglucose market share, but remains highly speculative given the uncertainties regarding potential demand for this commodity as a sweetener as well as the potential to increase production. Section 1.3 of the attached note elaborates on this issue.

On the other hand, the implications at Member State level are significantly biased by the assumption that isoglucose production will be distributed proportionately and not based on the actual potential of individual Member States to produce isoglucose. This leads to less distortive distributions compared to an alternative approach that would assume an allocation of demand changes to particular Member States or geographical regions based on production capacities. Furthermore, it is not considered in the IPTS simulations that a higher production of isoglucose will increase demand for maize or wheat, limiting the implications on land utilisation and total welfare.