The ACP experience of preference erosion in the banana and sugar sectors and possible policy responses to assist in adjusting to trade changes

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CONTENT

1. Understanding sources of preference erosion in ACP-EU trade

ACP countries traditionally enjoyed high margins of preference on EU sugar and banana markets as a result of the high-price policy pursued as part of the food-security objectives of the pre-1992 Common Agricultural Policy (CAP). Since its implications are far-reaching, the obvious point should be repeated that: *trade preferences can only exist where there is tariff protection*. As tariff protection is progressively dismantled (for whatever reason), this automatically leads to an erosion of the margin of tariff-preferences which ACP countries enjoy.

Currently[1] the value of traditional ACP agricultural-trade preferences are being eroded by five distinct, yet related, processes namely:

- the EU's internal process of reform of the CAP which is reducing the market prices of the affected commodities in the EU and hence reducing the value of traditional trade preferences;
- unilateral EU tariff reductions such as the 'Everything but Arms' (EBA) scheme for least developed countries (LDCs) and revisions to the Generalised System of Preferences (GSP);
- the erosion of the margin of tariff-preference enjoyed by ACP countries through the negotiation by the EU of bilateral trade agreements;
- the erosion of the margin of tariff-preference enjoyed by the ACP as a result of negotiated multilateral agreements on tariff reductions;
- the erosion of the margin of tariff-preference enjoyed by the ACP as a result of WTO dispute-settlement rulings.

Understanding the *sequencing* of the various sources of preference erosion in ACP-EU agricultural trade and the *dynamic interaction* between the various source of preference erosion is important for understanding both the impact of preference erosion on different ACP countries and the short-, medium- and long-term policy responses required to minimise the adverse effects on traditionally preferred partners in the ACP.

Of these processes of preference erosion in ACP-EU agricultural trade, by far the most important at the present time is the *impact of the process of CAP reform on the value of trade preferences* – since CAP reform has a direct bearing on the prices that ACP exporters obtain for their products on the EU market. It needs to be recognised that the process of internal reform of the CAP is the foundation for the EU's agricultural tariff offers, be they unilateral, bilateral or multilateral.

This is clearly illustrated by the exceptions made to the EU's 2000 EBA initiative in favour of LDCs, under which although the principle of full quota-free and duty-free access (including the waiving of all special duties) was the guiding principle, exceptions were made for sugar, rice and bananas, all sectors in which internal EU policy reform has been deferred.[2] The granting of full quota-free, duty-free access for LDCs was carefully sequenced with the implementation of reforms to the internal EU market-management regimes in these three sectors.[3]

Box 1.1 *CAP reform and agricultural trade liberalisation*

Since 1992 the EU has been implementing a process of agricultural reform involving a shift from support for the prices of agricultural products to support for incomes of agricultural producers. This process, which is ongoing has been slow (over 15 years to date) and expensive (there has been a 47 percent increase in funding from 1992 to 2004).

It has however allowed EU market prices to fall dramatically (around 50 percent for various cereals, 41 percent for rice products, 20 percent for beef, and in the coming years, 36 percent for sugar) without undermining farm incomes and in some instances, notably in the cereals sector, without undermining overall levels of production (cereals production rose by 23 percent between the 1991/92 and the 2003/04 seasons). This engineered decline in EU market prices has two important knock-on effects in terms of international agricultural trade:

- it reduces the need for export refunds to close the gap between EU and world market prices;

- it reduces the level of tariff protection required to prevent any disruption of EU agricultural markets.

This has a direct bearing on EU positions in the WTO on the elimination of export subsidies and disciplines on various forms of domestic agricultural support.

The underlying objective of this process of reform is to enhance the price competitiveness of EU food-and-agricultural products on domestic and international markets. This can be illustrated by the January 2003 European Commission (EC) report on "Prospects for EU agricultural markets" which noted that "aligning Community prices with those on the world market should therefore make it possible to export without subsidies, and therefore without quantitative ceilings. Community products will therefore be able to benefit from opportunities in a world market where the volume of trade is expected to increase significantly in the medium term".

It was this expectation of a closing of the gap between EU and world market prices through CAP reform which led in July 2002 to the then EU Agriculture Commissioner arguing in Japan that the EU agricultural system could be preserved without trade barriers, asserting that "protecting our farmers need not mean protecting our markets. We believe that preserving our agriculture system can be done without trade barriers".[4] Unfortunately for the EU, currency movements between the euro and the US dollar (the currency in which all major agricultural commodities are traded) has meant that hitting the target of world market prices has proved elusive, with EU prices in dollar terms moving substantially above world market price levels since 2003.

Nevertheless the ongoing process of internal agricultural reform is allowing the EU to pursue a much more aggressive position on global agricultural-trade liberalisation than would have been the case in 1992. A by-product of this process of reform has been an erosion both of the value of traditional ACP agricultural trade preferences and the margins of tariff-preferences which ACP countries enjoy on the EU market.

This implies that EU positions in WTO agricultural negotiations are in large part determined by the degree to which internal processes of CAP reform have been initiated in the sector concerned, and the market and price effects of these reforms. The "wild card" in EU calculations at the WTO level is the process of dispute

settlement, which is building up a body of case law the implications of which are far from clear. The uncertainty this is generating is increasingly influencing how the EU structures its internal reform process and what assurances and understandings it seeks as an integral part of any negotiated multilateral WTO deal. This creates a certain dynamic interaction between the various sources of preference erosion, a dynamic which in certain sectors (notably sugar and cereals) is getting increasingly complex as non-food uses for the basic agricultural raw materials (especially bio-fuels) are becoming more commercially attractive in the light of the public support measures being set in place. This is changing the market context within which EU trade policy is being formulated.

However the situation is highly fluid,[5] making the drawing up of appropriate, definitive policy responses very difficult. This suggests a need for quick-disbursing instruments (so that investments are not already commercially out of date when they finally come to fruition) and flexibility to shift within the response strategy in the light of technology and market-driven changes. It also suggests a need for supportive financial instruments in order to reduce commercial risks arising from rapidly evolving technologies.

Nevertheless it can safely be asserted that from an EU perspective what determines EU positions in WTO negotiations and the mandates granted to the EC for the conduct of bilateral trade negotiations is the progress made in reforming the CAP and wider developments in EU agricultural and rural-development policies.

Put simply, if CAP reform has not yet allowed EU market prices to fall, then no tariff-reduction offers can be made either bilaterally or multilaterally. EU tariff reductions or eliminations in the context of bilateral or multilateral agreements do however compound the problems caused by the erosion of the value of trade preferences arising from CAP reform, since they increase competition on EU markets in a context where prices are already falling.[6]

It should be noted that while one can differentiate conceptually between these five sources of preference erosion in ACP-EU agricultural trade, in practice they are increasingly overlapping as the process of liberalisation gathers momentum and the EU's policy agenda shifts to addressing "behind border" issues, which are seen as seriously impeding the operation of EU companies in areas where they are felt to enjoy a clear competitive advantage.

Box 1.2 *"Behind border" issues*

The "behind border" issues which the EC would like to see addressed as part of its new generation of free-trade-area agreements include "poor protection of intellectual property rights and patents. Closed markets for services and investment. Unfair state intervention which distorts prices and fair competition. Public procurement markets that remain closed to fair competition."[7] Since these policies affect areas in which the EU is felt to be strong and competitive, a far more aggressive approach to securing liberalisation in these areas is now to be pursued. However, the question arises: what does the EC have to offer to advanced developing countries to encourage them to accept such wide-ranging negotiations? The answer inevitably lies in the food-and-agricultural sector, since it is in this area where the EU maintains the highest levels of protection, two of the most highly protected of which are sugar (and sugar-based food products) and bananas. The EC's wider "behind borders" policy agenda could thus

come to carry important implications for the pace of preference erosion confronting ACP producers in the sugar and banana sectors.

It is nevertheless important to make such distinctions in order to design appropriate short-, medium- and long-term policy responses to ongoing processes of change. For example, if the principal source of ACP preference erosion in the sugar sector lies in the implementation of internal EU reform measures, yet, despite this reform process, there remains substantial additional value to be had in the EU market compared to world markets, then, for those ACP countries with significant exposure to sugar sales at world market prices, expanded duty-free access to the EU market offers scope for addressing the income losses arising from administratively determined EU price reductions. While for least-developed ACP countries a trade measure addressing this issue is already in place (the removal of quota limits on EBA sugar access), for non-LDC low-cost ACP sugar producers, such as Swaziland, Guyana, Belize, Fiji and Zimbabwe, no such policy measure is in place. In the short term (i.e. while there is additional value to be had on the EU market – almost certainly until at least 2015), it makes sense to secure such expanded duty-free access as soon as possible. The additional revenues that this would generate could then be used to address existing impediments to competitiveness, so that by the time sugar-sector preferences have finally been eroded, production and marketing costs should have been reduced to competitive levels.

2. Preference erosion in the banana sector: sources and impacts

2.1 Understanding sources of banana-sector preference erosion and differential impacts

In the banana sector four distinct phases of preference erosion can be identified in the ACP-EU banana trade:

- the creation of the single internal market and the opening of the UK market to competition from non-traditional suppliers, including from within the EU (from 1993);
- the initial modification of the EU trade arrangements for bananas in an attempt to resolve the WTO dispute (from 1999);
- the movement over to a tariff-only regime from 1 January 2006;
- the implementation of EU banana-sector reforms and associated modifications of the EU trade regime for bananas (pending).

In terms of the impact of preference erosion a distinction needs to be made between different ACP economies, whose underlying costs of production and transportation are very different (this applies as much to sugar as it does to bananas).

In the ACP banana sector the main distinction is between traditional Caribbean-island suppliers[8] (which by virtue of their geographical situation face not only high production costs but also high shipment costs) and more competitive banana producers in Africa (Côte d'Ivoire and Cameroon) and the Caribbean (the Dominican Republic), whose underlying cost structures are lower and more on a par with "dollar banana" producers. There is of course an intermediate group including Surinam and Belize, where organisational reforms, productivity gains and improved marketing strategies could result in them joining the group of competitive suppliers that are

capable of profitably serving the EU market, even in a context of the tariff-only regime and EU banana-sector reform. In this context of widely differing cost structures, so long as the ACP as a group continue to enjoy significant margins of tariff-preference over non-ACP banana suppliers, any decline in the value of traditional preferences or reduction in the margin of preferences, via its price effects, will impact first and foremost on traditional high-cost Caribbean suppliers. However these effects can be mediated by a revision of marketing-and-production strategies to target the "luxury purchase" component of the EU market, notably the "fair trade" market where the underlying objective is to insulate producers from price declines by guaranteeing a pre-determined price for their product.[9]

2.2 The EU single internal market and the impact of a single banana regime

The creation of a single EU import regime in 1993 brought with it a strong downward pressure on prices in the UK market, the principal market for bananas from traditional Caribbean-island suppliers. Two years after the entry into force of the single EU regime, UK banana prices were 33 percent below their 1991 peak (see Table 2.1.). While prices subsequently recovered, the value never again exceeded the 1995 value in real terms, when banana prices reached their lowest point in nominal prices.

This primarily affected traditional Caribbean suppliers from the Windward Islands, whose market share in the UK shrank from 52.1 percent in 1990 to 28.4 percent in 1996 and 19.6 percent in 2002. With the UK market for banana imports growing from 470,000 tonnes in 1990 to 749,000 tonnes in 2000, the principal non-EU beneficiaries of this market growth were Costa Rica, Cameroon, the Dominican Republic, Belize, Honduras, and Côte d'Ivoire.

Table 2.1 *UK retail banana prices*

	1991	1992	1993	1994	1995	1996	1997	1998	1999
Retail price £/kg	1.19	1.06	0.96	0.94	0.80	0.89	1.00	1.04	1.02
Real price (1990=100)	100.0	98.4	84.7	75.4	72.2	59.4	64.5	70.2	70.6

Source: Extracted from table 4.2 'Nominal and Real retail prices of Banana in the UK 1990-2003' in "Banana Exports from the Caribbean Since 1992", Preliminary report, National Economic Research Associated (NERA), 18 June 2003.

On the UK market over this ten-year period "dollar banana" suppliers increased their exports slightly more than other ACP suppliers. However the main beneficiaries of the new banana regime were EU suppliers, with imports to the UK market growing from 55,000 tonnes in 1990 to 194,000 tonnes in 2000 (see Table 2.2.). Only since 2002 have dollar-bananas displaced the EU as the main source of UK banana imports. This illustrates the internal nature of the preference-erosion dynamic in the early years of preference erosion in the banana sector.

Table 2.2 *Imports into the UK (selected countries, selected years)*

	1990		1996		2000		2002	
	'000 tonnes	share	'000 tonnes	share	'000 tonnes	share	'000 tonnes	share
Windward Islands	245	52.12%	192	28.44%	155	20.69%	100	12.00%

Cameroon	3	0.64%	25	3.70%	43	5.74%	94	11.28%
Côte d'Ivoire	-	-	23	3.41%	11	1.47%	7	0.84%
Dom. Rep.	-	-	1	0.15%	30	4.01%	63	7.56%
Belize	24	5.10%	52	7.70%	60	8.01%	30	3.60%
Jamaica	63	13.40%	89	13.19%	41	5.47%	41	4.92%
Surinam	28	5.96%	26	3.85%	34	4.54%	7	0.84%
Columbia	11	2.34%	5	0.74%	1	0.13%	73	8.76%
Costa Rica	11	2.34%	57	8.44%	129	17.22%	182	21.85%
Honduras	13	2.77%	7	1.04%	39	5.21%	1	0.12%
Total "dollar bananas"	35	7.44%	69	10.22%	169	22.56%	256	30.73%
EU	55	11.70	177	26.22%	194	25.90%	197	23.65%
Total	470		675		749		833	

Source: Extracted from table 2.3 'Imports into the UK 1990-2002' in "Banana Exports from the Caribbean Since 1992", Preliminary report, National Economic Research Associated (NERA), 18 June 2003.

For traditional Caribbean banana suppliers, therefore the first level of erosion of the value of banana preferences occurred as a result of internal EU policy changes, not as a consequence of the WTO dispute. EU banana suppliers were the principal beneficiaries of preference erosion on the UK market, with supplies more than tripling (up from 55,000 to 194,000 tonnes). The adverse price effects on the UK market of the creation of a single internal EU market for bananas were counteracted in the case of low-cost ACP banana suppliers by an expansion of market-access opportunities. This has proved important in the overall response to the price consequences of erosion of the value of ACP banana-sector preferences for lower-cost ACP suppliers. The aid aspects of the EU policy response were then able to support the exploitation of the new trade opportunities that emerged.

Box 2.1 *The roots of preference erosion in the banana sector*

Prior to July 1993 there was no common EU trade regime for bananas, rather bananas were imported through various national regimes. The regimes in place in France, Italy, Portugal, Spain and the UK provided preferential access for home producers and exporters in ACP countries with which there had been a previous colonial connection. The national regimes in Belgium, Denmark, Ireland, Luxemburg and the Netherlands applied the CET rate of 20 percent while Germany was permitted duty-free imports. The continued existence of these national regimes was inconsistent with the adoption of the single European market in 1993 and hence needed to be replaced by a single common EU regime. The regime adopted on 1 July 1993 had the following main features:

- A quota of 857,000 tonnes free of duty for quantities imported from traditional ACP countries, with amounts specified for individual countries.

- A quota of 2,000,000 tonnes to cover non-traditional ACP countries and third countries (essentially "dollar" producers), subjected to a duty of €100 per tonne.

- A licence system which distinguished between operators marketing EU-produced and ACP-produced bananas (category 'B' licences) and established operators in the EU marketing non-traditional ACP bananas and "dollar" bananas (category 'A' licences).

- An out-of-quota tariff on non-traditional ACP bananas of €750 per tonne and €850 per tonne on third-country quantities.

- Deficiency payments on Community-produced bananas up to 854,000 tonnes.

It was the administrative arrangements for the implementation of the new regime that provided the basis for a challenge under the WTO. However, the earlier regime had also been subject to challenge under the GATT, creating from the outset a WTO dimension to the internal process of reform and management of the external trade regime.

2.3 The impact of the WTO dispute

After the decline in Windward Island exports to the EU between 1991 and 1996, induced by the coming of the single market, banana exports held up surprisingly well from 1997 to 2000, averaging annually around 137,000 tonnes (compared to an annual average of 207,000 tonnes from 1992-1996). However with the ending of country-specific quotas from 1999, and the implementation of the agreement which resolved the WTO banana dispute from July 2001 a further decline in Windward Island banana exports occurred.

Table 2.3 *Windward Island exports to the EU: trends 1996-2005 (tonnes)*

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
St Lucia	106,670	71,000	70,000	66,000	73,000	34,727	49,313	32,520	42,874	28,243
St Vincent	44,176	30,000	39,000	38,000	43,000	30,829	32,522	20,919	23,969	15,895
Dominica	39,307	35,000	27,000	28,000	28,000	18,062	17,802	10,823	12,401	13,182
Grenada	2,007	0	0	1	1	591	557	448	406	-
Total WI	192,160	136,000	136,000	132,000	144,000	84,209	100,194	64,750	79,650	57,320
Total ACP	801,596	667,000	602,000	675,000	753,000	727,414	723,235	787,931	782,167	760,040
% WI/ACP	24.0%	20.4%	22.6%	19.6%	19.1%	11.6%	13.9%	8.2%	10.2%	7.5%

Source: Composite table, for 1992 see 'External Trade of the European Union with ACP Countries and OCTs 1992-1996', for the period from 1997-2000 table, 2.3 'Imports into the UK 1990-2002' in "Banana Exports from the Caribbean Since 1992", Preliminary report, National Economic Research Associated (NERA), 18 June 2003, for the period from 2001 to 2005 see http://europa.eu.int/comm/trade/issues/bilateral/regions/acp/stats.htm

With the full implementation of the new regime from July 2001, the basis for the negotiation of commercial contracts was transformed, and by August 2002 retail prices had begun to tumble in the UK market, falling 31.5 percent by January 2004 relative to July 2002. These price declines compounded the difficulties created by administrative reforms which de-linked access to 'B' quota licences from imports of ACP bananas and ended country-specific quotas under the ACP regime.

Over the period from 2000 to 2005 banana exports from the Windward Islands declined by 44 percent on average compared to the preceding period[10] (and 60 percent between 2000 and 2005 which was a particularly poor year – see Table 2.3).

Box 2.2 *The WTO banana dispute*

The preferential arrangements for ACP banana suppliers were subject to challenge under both the GATT and the WTO. Problems emerged from the outset of the establishment of a common EU import regime. This regime introduced three types of licences for importers of 2 million tonnes of fruit:

- 65 percent of licences were allocated to traditional operators involved in dollar bananas" ('a' licences);

- 30 percent of licences were allocated to traditional importers of EU and ACP bananas ('b' licences);

- the balance was allocated to newcomers.

Latin American suppliers were concerned about the new regime for two main reasons: first the small size of the quota to which the low tariffs applied, which was below the level of their exports to the EU in 1992 (2.8 million tonnes) and the punitive nature of the out-of-quota tariff; second the imposition of duties on imports into Germany for the first time.

Five of the aggrieved Latin American suppliers complained to the GATT, with the USA supporting this action. In 1994 a GATT dispute panel ruled in favour of the complainants. The EU sought a compromise in response to this decision, increasing the quota initially to 2.1 million tonnes and subsequently to 2.2 million tonnes. However, the compromise reached unravelled around the issue of the allocation of country quotas and the management of the import-licensing arrangements**.** In 1996 Ecuador, Guatemala, Honduras, Mexico and the USA initiated actions under WTO rules.

In September 1997 the WTO Dispute Settlement Body ruled, finding the EU in violation of WTO rules on around a dozen counts, particularly with reference to the agreement on import-licensing procedures. The EU was granted 15 months to comply with its WTO obligations, so the deadline for amending the regime was the end of 1998**.** A revised scheme, which had been amended in ten ways following the earlier WTO ruling was then implemented by the EU from 1 January 1999 based on:

- a 2.553 million tonnes tariff quota;

- an additional quantity assigned globally to the ACP.

However on 6 April 1999 this new revised regime was also found to be in violation of the EU's WTO commitments on the basis of:

- the setting aside of a quantity solely for ACP imports;

- the specific historical reference period (1994-96) used to calculate the allocation of licences.

This, it was felt, did not reflect the operation of the free market and perpetuated the "drag" on discrimination vis-à-vis third-country operators (this applied not only to the ACP quota but also to the quotas allocated to some other suppliers).

The April 1999 WTO panel ruling authorised the USA to suspend concessions offered to the EU, allowing temporary sanctions to the value of US$191 million, and on 9 April 1999 the USA issued a list of products where concessions to the EU were to be suspended.

On 2 May 2001 the EC announced new tariff-quota arrangements designed to bring the dispute in the WTO to an end. The agreement reached was a two-phase arrangement involving a transitional tariff-quota arrangement to run from July 2001 to 2006 and the establishment of a flat-tariff system after 2006.

Meanwhile between 2000 and 2002 "dollar banana" exports to the UK market (the principal market for Windward Island bananas) shot up by 51 percent and those of Cameroon and the Dominican Republic doubled (see Table 2.2.). These trends have continued, with Windward Island banana exports hitting an all-time low of 57,320 tonnes in 2005.

It had been widely recognised that having lost the substantive case in the GATT, any final WTO ruling would exacerbate the difficult position of traditional Caribbean banana producers. This saw the number of registered growers in the Windward Islands fall by 78 percent, from 24,650 to 5,475 in the ten years from 1992 to 2002 (see Table 2.4). The departure of growers from banana production in some areas is leading to land abandonment and land degradation, as well as serious social dislocation. These factors need to be taken into account and addressed if they are not to undermine the environment for investment in diversification either within or outside of agriculture. This consideration highlights the importance of a social-adjustment dimension to any comprehensive policy response to preference erosion.

Table 2.4 *Major impacts in the Windward Islands*

	1992 (tonnes)	2002 (tonnes)	% change
Production	279,812	99,089	- 65%
Number of active growers	24,650	5,475	- 78%
Earnings (millions of Eastern Caribbean dollars)	376.2	117.7	- 69%

Source: "Mid Term Review of the Negotiations of an Economic partnership Agreement (EPA) between CARIFORUM and the EU: Implications for Agriculture and Farmers of the Windward Islands", Claudius Preville, 9th November 2006 at http://www.acp-eu-trade.org/library/files/Preville_EN_09112007_WINFA_Midterm-Review-of-the-negotiation-of-an-EPA-between-CARIFORUM-and-EC.pdf

Currently there are signs that the situation in the Windward Island-banana sector may be stabilising with investments in developing production to serve a "luxury purchase" component of the UK market bearing fruit. In December 2006 Sainsbury's, one of the UK's largest retailers of bananas – selling over half a billion bananas a year – announced that it was shifting over to 100 percent "fair trade" labelled banana sales. This would appear to create substantial new market opportunities for Windward Island banana producers, doubling at a stroke the market for "fair trade" bananas in the UK and generating social premiums on "fair trade" bananas of around €6 million in 2007 alone.[11]

However it should be noted that this response strategy – involving a shift over to "quality" production, which meets specified standards, so as to be able to serve particular premium-priced markets – itself may well have contributed to the exodus of producers from the banana industry. This again highlights the need for social-welfare and diversification measures as an integral part of any response strategy to preference erosion**.** This point is reinforced by the experience of a low-cost ACP sugar producer – Swaziland – in the face of preference erosion.

In contrast to this Windward Island experience, between 1996 and 2005 Cameroon's banana exports to the EU increased by 52 percent, the Dominican Republic's by 138 percent and Belize's by 37 percent (see Table 2.5). The reality was that competitive ACP banana suppliers were left largely unaffected by the first two phases of preference erosion. Indeed their position on the EU market strengthened (in part with

the benefit of EU banana-sector adjustment support – particularly in Cameroon) allowing an expansion of production and employment in the sector. The fact that the more competitive ACP banana suppliers (with the exception of Côte d'Ivoire) have been able to raise their exports to both the UK and the wider EU market in the face of the outcome of the WTO dispute which involved significant administrative reforms, highlights the centrality of the tariff-only issue.

Table 2.5 *Competitive ACP banana suppliers: trends 1992-2000 ('000 tonnes)*

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Côte d'Ivoire	181	166	158	193	200	218	211	205	211	183
Cameroon	166	157	116	161	205	216	230	293	262	253
Dom. Rep.	61	49	56	42	60	86	97	109	101	145
Belize	54	53	53	56	69	52	38	74	80	74

Source: For figures for 1996-2000 see table 2.2 'Supplies of Banana to the EU-15 1990-2002' in "Banana Exports from the Caribbean Since 1992", Preliminary report, National Economic Research Associated (NERA), 18 June 2003, 2001 to 2005 see country data at http://europa.eu.int/comm/trade/issues/bilateral/regions/acp/stats.htm

Box 2.3 *Understanding the evolving EU markets for "luxury" and "necessity" purchases*

The United States Department of Agriculture (USDA) has suggested that two distinct components of the EU food market can now be identified: "necessity purchases" and "luxury purchases". According to this analysi,s in the "necessity-purchase" component of the market, price competition is intense, with consumers making purchase decisions primarily on the basis of price. In the "luxury-purchase" component of the market in contrast, "quality" standards, ethical factors or methods of production play a more important role in the purchase decision of consumers than price considerations.

While products have always been differentiated on quality grounds, under the impact of CAP reform the price significance of this product differentiation has become more pronounced. As the floor price for basic commodities has been allowed to fall, so the gap between prices of bulk commodities and differentiated products has widened. Indeed, "luxury purchase" products and "necessity purchase" products are now subject to divergent price trends, with the former generally enjoying rising price trends, while the latter generally face declining prices. This carries important implications for ACP producers who will have to make the transition from simply "trading" into general EU markets, to "marketing" specific differentiated products into particular components of the EU market.

In the banana sector two important areas of the "luxury purchase" component of the market are "fair trade" bananas and "organic" bananas. It is these components of the EU market which traditional ACP suppliers (e.g. the Windward Islands for "fair trade" bananas) and new Caribbean ACP suppliers (Dominican Republic for "organic" bananas) are seeking to serve. Indeed, the aim of the Windward Island banana exporters is to be exclusively serving the "fair trade" market by the end of 2007.

2.4 The tariff-only regime

Preference erosion has only become significant for lower-cost ACP banana suppliers in Africa and the Caribbean since the introduction in 2006 of a tariff-only regime. Negotiations over the level of the tariff to be applied were fraught, with the ACP consistently arguing that different proposals set the tariff too low whereas the "dollar banana" suppliers consistently argued that the proposed tariff was too high (see Box 2.4).

Press reports indicate that since the introduction of the new regime on 1 January 2006 "dollar banana" exports to the EU have increased by 200,000 tonnes, rising by 8.2 percent in the first 11 months of the year.[12] As yet this has not affected production and exports to the EU from competitive ACP banana suppliers. It will however further increase pressures to reduce costs and maximise returns on exports through the development of more sophisticated marketing strategies designed to serve the quality-conscious component of the EU market (the so called "luxury purchase" component of the EU market).[13] This being said, the introduction of the tariff-only regime has been quickly followed by the adoption of proposals for the reform of the EU domestic banana regime, which is likely to make it very difficult to disentangle the price effects of these two measures.

Box 2.4 *Evolution of the banana tariff proposal*[14]

Chronology	**What was said at the time**
June 2004 Opening of negotiations with Latin American suppliers on the level of the flat tariff to be applied under a tariff-only system.	The Commission's objective is to "maintain the same level of protection and preference for ACP countries as the existing regime provides". Press release IP/04/707-02/06/2004
October 2004 Informal discussions held with Latin Americans.	According to Commissioner Lamy this tariff "would keep market shares steady and maintain market access to the EU". ICTSD (Vol. 8, No. 37, 3 November 2004)
27 October 2004 €230/tonne tariff is announced. 31 January 2005 €230/tonne tariff is officially notified to the WTO.	"The EC will maintain a preference for ACP countries in a manner respecting entirely the EU's obligations and commitments towards all interested parties". Press release IP/05/118-31/01/2006
30 March 2005 Latin Americans launch an official challenge in the WTO and go to arbitration. 1 August 2005 WTO arbitration rules in favour of Latin American banana suppliers.	"The EU banana regime is changing but the level of protection is not increasing … I believe this figure and methodology has allowed us to square the circle and safeguard the sometimes conflicting interests of our consumers, producers and trading partners".

12 September 2005 New EC proposal of €187/tonne is put forward. Consultations with Latin American banana suppliers. 26 September 2005 EU requests second WTO arbitration.	Mariann Fischer Boel, press release IP/05/377-31/03/2005 "The tariff proposed by the EU was designed to be a neutral and fair conversion that would maintain current market access for all banana suppliers to the EC". Peter Mandelson, press release IP/05/1030-02/08/2005 "The Commission's new proposal confirms Europe's commitment to ending this long-standing dispute. We have been careful to ensure that preferential access for our ACP partners is maintained". Peter Mandelson, press release IP/05/1127-12/09/2005
27 October 2005 WTO arbitrator rejects EU proposal for a tariff of €187/tonne.	"We are surprised and disappointed that the arbitrators did not back our proposal. We believe that the system we proposed would have maintained access to our markets in a fair manner". Mariann Fischer Boel, press release IP05/1359-27/10/2005
December 2005 EC announces a tariff of €176/tonne. 1 January 2006 New flat-rate tariff of €176/tonne comes into force.	"This is a fair and balanced result for everyone, which will fully maintain access for Latin American producers while continuing to take into account EU and ACP producers". Mariann Fischer Boel, press release IP/05/1493-29/11/2005

2.5 The CAP-reform dimension

The proposals for reform of the EU banana regime which have been adopted by the EU Council involve incorporating support to EU banana producers into the single farm payment regime and the POSEI programme for the outermost regions of the EU. The aim is to bring the banana regime "into line with reforms in other agricultural sectors".[15] In other sectors of the EU the initiation of such reforms has resulted in substantial declines in market prices in the EU.

This would appear to be the expectation in the banana sector, for the November 2006 EU Agricultural Council discussion of the banana-sector reform proposals highlighted the high "safety margin" in the financial provisions being made (some 58.5 percent of the €280 million budgetary allocation). In response the EC explained that the "purpose of the safety margin was to take account of the variations in banana prices

which may result from changes in the import regime".[16] This extra budgetary allocation strongly implies that with EU banana-sector reform, modifications to the banana-import regime will become more likely (either in response to further WTO challenges or as an autonomous response to the reform process) and that this will result in declines in the prices of bananas on the EU market (hence the higher allocation to cover additional payments to EU banana farmers).

This has important implications for ACP banana suppliers, particularly of course those from traditional Caribbean-island economies. The level of price declines implicit in a 58.5 percent safety margins included in the EU budgetary allocation to finance reform[17] (accounting for approximately a €123 per tonne price decline), could well effectively drive traditional Caribbean-island suppliers out of all but niche markets for bananas in the UK (such as fair-trade or organic banana markets). In this context Sainsbury's decision to move over to 100 percent fair-trade bananas may well have come just in the nick of time for Windward Island banana producers, for without it the extension of CAP reform to the EU banana sector could well have come to sound the death knell of traditional exports of bananas from the Caribbean-island economies.

In addition, of course, price declines of around €120 per tonne could place serious financial pressures on competitive ACP suppliers, who will need to substantially restructure their production and distribution systems to cut costs and maintain profitability. This highlights the importance of speedily setting in place support programmes to help low-cost ACP banana producers to reduce production costs, improve yields and quality, increase the efficiency of distribution and enhance marketing efforts to serve increasingly differentiated EU markets. However this could prove extremely difficult in Côte d'Ivoire and difficult in Cameroon, where problems of governance, can impose substantial additional costs on banana-sector operators. Such costs will prove increasingly difficult to carry as prices fall on the EU market.[18]

Of course the interface between domestic agricultural policy reform in the EU and the WTO dispute-settlement process is far more complex in the banana sector than in other sectors, given the pioneering role which has been thrust upon the banana sector in developing WTO jurisprudence. In this context, where the domestic space for such action exists or can be created, the EU is taking anticipatory steps in the expectation of the outcome of WTO disputes, or with an eye to reducing support for such litigation amongst potential complainants. This makes tracking the origins and impact of individual measures contributing to preference erosion increasingly difficult. However, given the advanced stage of preference erosion in the banana sector and the increasing pace of change, this is not necessarily a major constraint in developing appropriate policy responses and policy tools.

2.6 The experience of the EU policy response in the banana sector

2.6.1 The provision of restructuring support

The first EC policy response to preference erosion was to provide financial support to enhance competitiveness in affected ACP producing countries. This has taken the form of two major assistance programmes:

- the 1994 special programme of assistance to traditional ACP banana producers (SPA), to which €95 million was allocated;

- the 1999 special framework of assistance for traditional ACP suppliers of bananas (SFA), to which €287 million was allocated from 1999-2005.

These two programmes have provided the EC with considerable experience of support in addressing the challenges arising from the processes of preference erosion. As a consequence the EC's approach has over time become more pro-active, systematic and some would say realistic. Although critically, constraints on aid delivery and growing procedural complexity continue to undermine the effectiveness of the policy response.

2.6.2 The 1994 special programme of assistance (SPA)

The SPA for traditional ACP banana producers was established in the light of the recognition that moves towards a single internal market in bananas within the EU would be likely to adversely effect the position of traditional Caribbean banana suppliers. The aim of this initial programme was essentially to enhance the competitiveness of ACP banana producers. It implicitly assumed that all traditional ACP banana suppliers could be assisted to attain market competitiveness – with the level of assistance nominally being linked to the competitiveness gap. It provided a wide spectrum of support to banana-sector adjustments. According to the EC's own evaluation report, by far the most effective support was that directly co-financed with producers in support of their own plans to improve field-level productivity.[19] This was particularly the case in Cameroon where a co-financing arrangement was used in association with the companies concerned. Assistance to reforming management structures and marketing arrangements, while deemed to have been important areas to be addressed, proved less effective in the short term. With the exception of Cameroon, implementation delays were common, largely linked to the tendering procedures used. This served to undermine the effectiveness of the assistance deployed.

Given the trends in banana exports to the EU from ACP suppliers, the 2000 evaluation of the 1994 programme argued that there was a need to abandon the myth that all ACP banana producers could be made competitive and that rather more attention should be paid to supporting efforts at diversification and addressing social adjustments in affected banana-growing areas. This conclusion however largely neglects the increasing differentiation within the EU market on grounds of quality and production methods and the growing price differentials between "necessity purchase" and "luxury purchase" products within individual sectors.[20]

Nevertheless, these recommendations have largely been taken on board in the implementation of the ten-year ACP banana-sector-assistance programme launched in 1999 called the special framework of assistance for traditional ACP suppliers of bananas (SFA), where far greater emphasis was placed on support for diversification (both within agriculture and beyond), social adjustment and general government development plans.

2.6.3 The 1999 special framework of assistance (SFA)

A key feature of the 1999 SFA was the requirement for countries to draw up comprehensive frameworks for the deployment of SFA support, with annual allocations then being determined within this multi-annual framework. Overall the 1999 SFA contained a financial allocation of €287 million for the first part of the ten-year period, a substantial expansion of the funding available under the SPA. In addition to this increase in financing, the geographical coverage of the 1999 SFA programme was extended, covering twelve instead of seven ACP banana-producing

countries (Belize, Cameroon, Cape Verde, Côte d'Ivoire, Dominica, Grenada, Jamaica, Madagascar, St Lucia, St Vincent & the Grenadines, Somalia and Surinam). Despite the extension of the geographical coverage, approximately 50 percent of the funds allocated between 1999 and 2005 were deployed in the Windward Islands.

On the basis of the SPA experience in the Windward Islands, a far more sophisticated programme was developed under the SFA, involving interventions at four distinct levels:

- supporting competitiveness within the banana sector;
- promoting diversification within the agricultural sector;
- supporting broader economic diversification outside of agriculture;
- supporting social adjustments linked to the contraction of the banana sector.

A wide variety of activities were supported within each of these four levels, involving policy choices and the resolution of key questions related to the aims of programme. The multiplicity of choices faced in deploying adjustment support related to preference erosion reflects the complex knock-on effects which can occur and the very real constraints which exist in engaging with the global economy in many of the single-commodity-dependent countries which are worst affected by the process of preference erosion.

Box 2.5 *The policy choices faced in the deployment of banana-sector adjustment support*

When looking at the deployment of adjustment support related to preference erosion key questions arose regarding the underlying aims at each level where adjustment needs arose. In terms of banana-sector adjustment, was the aim to support field-level productivity improvements, to enhance price competitiveness or to improve quality of production so as to increases the returns of sales by serving niche markets? Should the focus be on handling, packaging and marketing so as to move up the value chain (packed and bar-coded bananas) or should it be to support improved management of the sector so as to reduce overheads and increase returns to farmers? Should the focus be on supporting the development of infrastructure to reduce transportation costs (inland and at the port) or on supporting the financial restructuring of the sector?

Within the wider agricultural sector is the aim merely to identify alternative crops? Or to directly support the production of these crops? Or to establish financing instruments to support the private sector in developing these alternative products? Or should the aim be to support the development of marketing infrastructure to serve markets for alternative agricultural products? Or should the aim be to improve the general economic infrastructure for agricultural development and the general management and policy framework for agricultural development? Or should government restrict its aim to the provision of extension services to disadvantaged groups to help them take up known commercially viable alternative crops?

At the level of the wider economy should the aim be to support the creation of small- and medium-sized enterprises in rural areas via the creation of loan-finance instruments and a business-support service infrastructure? Or should government seek to play a more direct role in employment creation through public-works programmes to counter the direct deflationary effects in the worst-affected areas. Or should it merely focus on providing access to retraining opportunities and improving adult-education services?

With regard to the social-adjustment dimensions should the aim be to support early retirement of aging smallholder farmers as part of a wider process of agricultural restructuring or to sustain rural infrastructure in the face of the income losses caused by preference erosion? Or should the aim be to sustain access to health, education, housing provision and public-utility provision for communities affected by preference erosion?

Against this background two key issues arise in formulating appropriate policy responses to the challenges thrown up by preference erosion:

- where should the emphasis be placed in programme design and implementation?
- who should be responsible for determining priorities and emphasis within the programme?

This is not as simple and straightforward an issue as it would at first appear. Different stakeholders have very different interests, with governments often not being independent arbitrators, but rather deeply concerned and affected stakeholders themselves. How these basic questions are addressed will affect the channels and instruments used for aid deployment, which in turn will impact on the efficiency of aid delivery and its effectiveness.

2.7 Lessons from banana-sector experience

2.7.1 Recognising the constraint of limited government capacity

Preference erosion often involves large-scale losses of income to private-sector organisations and the balance of payments. These losses can be far greater than annual aid flows from the EC to the countries concerned, particularly in small countries. In this context setting in place programmes of assistance to get to grips with the economic consequences of preference erosion can lead to a rapid and substantial expansion of aid allocations to the affected countries. Put simply, in seeking to address problems associated with preference erosion, external donors often require public administrations to take on the management of a major expansion of external assistance programmes and this can overwhelm local administrative capacities. This was the case in the Windward Islands where from 1999-2005 a four-fold increase in the volume of the EC aid allocation occurred (compared to the National Indicative Programme allocations).

Table 2.6 *Situation of allocations and payments, December 2004*

Country 9th EDF NIP	1999-2005 SFA allocation	Total payments	% payments
St Vincent €5.0 m	40,589,801	3,119,992	7.7%
St Lucia €4.5 m	58,234,810	16,043,206	27.5%
Dominica €15.7 m	43,513,625	4,531,201	10.4%
Grenada €11.3 m	4,000,000	399,974	10%
Total	146,338,236	24,094,373	16.5%

Source: Extracted from the Joint Annual report on cooperation between the EC and various Windward Islands. These reports can be found at:

St Vincent, at: http://www.delbrb.cec.eu.int/en/eu_and_country/stvincent_overview.htm .
St Lucia at: http://www.delbrb.cec.eu.int/en/eu_and_country/stlucia_overview.htm
Dominica at: http://www.delbrb.cec.eu.int/en/eu_and_country/dominica_overview.htm
Greneda at: http://www.delbrb.cec.eu.int/en/eu_and_country/greneda_overview.htm

This can pose particular problems of course where donor procedures for aid mobilisation and deployment are themselves complex. In this context expanded aid allocations do not always result in increased levels of aid deployment. This can considerably undermine the effectiveness of the policy response to preference erosion.

One way of addressing the problem of the limited capacities of public authorities in managing expanded aid programmes is to bring producer organisations in the affected sectors into the process of design and management of programmes of assistance. However this in itself can be problematical. In order to bring producer organisations effectively into this process substantial investment in organisational development may be required, an investment which needs to be carefully managed if the representative functions of these bodies is not to be undermined. Promoting such involvement however would appear to be essential if assistance is to be efficiently and effectively deployed in support of sector-specific programmes.

This issue of the efficiency of aid delivery in supporting what are "time sensitive" processes of adjustment is extremely important, for delays can become crippling. This is evident in the experience in the Windward Islands, where by December 2004, of the €146 million allocated under the first six years of the SFA only €24 million (16.5 percent) had been paid out, with the best-performing country having spent only 27.5 percent of available funding and the poorest-performing country having spent only 7.7 percent of the available assistance.

More seriously a detailed look at the figures reveals that while annual allocations were being made within a multi-annual framework, by December 2004 in some countries no expenditures had been made on annual programmes for 2001, 2002, 2003 and 2004, while less than half the funds allocated under the 1999 programme had been spent, and no more than 5.6 percent of the funds allocated under the 2000 programme. This suggests that such arrangements are not conducive to minimising delays in aid deployment.

This conclusion is reinforced by the conclusion of the 2004 joint annual reports on EC cooperation with St Vincent and St Lucia, which observed that:

> expenditures of SFA resources in 2004 was hampered by the introduction of the new financial regulations which applied to SFA 2003 and subsequent financing agreements and to contracts not yet entered into on earlier SFAs.

It would appear to be essential to move beyond public-sector capacity constraints in getting to grips with time-sensitive adjustment processes if an effective response to preference erosion is to be supported. However, closely linked to this is the issue of EU aid procedures. These procedures were largely drawn up with cooperation activities with public authorities in mind, and are simply not designed to be responsive to private-sector-led time-sensitive adjustment processes. A fundamental review of aid-deployment procedures used when supporting programmes to address the consequences of preference erosion is thus also needed.

2.7.2 Recognising the role of industry players

The role of industry players in addressing the productivity-improvement challenge is well illustrated by the experience of the Cameroon banana sector. Here programmes to improve field-level productivity were supported, based on the banana industry's own plans for improving yields and reducing costs. These plans were then co-financed on a 50/50 basis from the special programme of assistance for ACP banana producers. This carried a number of distinct benefits. It greatly facilitated the disbursement of funds, since tendering procedures were simplified and actions could be pre-financed, since disbursements were made against receipts from the companies concerned. This latter aspect of the management of this programme of support greatly increased the transparency of the operations and facilitated control of expenditures. It also served to greatly simplify the administration of the assistance by the EC, since most of the burden of administration was placed on the companies involved in implementing the field-level improvements. These companies of course had a strong stake in good administration, since they would not get their money back if they could not verify the expenditures made.[21]

Indeed overall the early experience under the EC special assistance programmes in favour of ACP banana producers demonstrates that programmes of support for enhancing competitiveness are most effective where assistance is provided directly, on a co-financed basis in support of economic operators' own investment plans. In the case of Cameroon, Côte d'Ivoire and Belize, EC support has contributed to improvements in competitiveness which have enabled these countries to expand their exports to the EU since 1992, as and when the opportunity arose, with the implementation of various administrative reforms.

In the case of Cameroon the early delivery of support to production improvements directly assisted the banana industry in maximising the benefits to be obtained on the EU market, while the value of preferential access to the EU market was high. This has enabled the industry to get to grips with broader problems of competitiveness, which could have placed the industry in a solid position to maintain its market share in the EU in the face of preference erosion arising from the introduction of a tariff-only trade regime from 1 January 2006 following the WTO dispute settlement, and the price declines which will arise following the impending reform of the EU banana regime.

Table 2.7 *Evolution of Cameroon's changing market share (selected years – tonnes)*

	Cameroon exports	Total EU supplies	Market share
1990	78,000	3,722,000	2.1%
1995	165,000	3,762,000	4.4%
2000	205,000	(EU-15) 4,081,000	5.0%
		(EU-25) 4,682,000	4.4%
2004	262,000	(EU-25) 4,620,000	5.7%

Source: Composite table drawing data from Cameroon country data at http://europa.eu.int/comm/trade/issues/bilateral/regions/acp/stats.htm; data from table 2.2 'Supplies of Banana to the EU-15 1990-2002' in "Banana Exports from the Caribbean Since 1992", Preliminary report, National Economic Research Associated (NERA), 18 June 2003 and data from "Banana CMO Reform" EC Memo/06/335-20/09/2006 http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/06/335&format=HTML&aged=0&language=EN&guiLanguage=fr

It is no means certain however that this successful model of support to industry-led productivity improvements in preparation for the impact of preference erosion, would still be possible under new EU procedures (see later conclusions reviewing the current experience in the sugar sector). Indeed, there would appear to be a number of policy issues which arise linked to the deployment of grant-financed aid in support of ACP private-sector enterprises, questions which a number of EU member-state governments are distinctly uncomfortable with.

These questions and the underlying issues need to be identified and addressed pragmatically at the time of the establishment of the programmes of assistance to meet the challenge of preference erosion, in the light of the need to support the countries which are the principal "losers" from the process of multilateral trade liberalisation**.** Ideological considerations linked to wider policy agendas of major funding agencies should not be allowed to colour the determination of what can be done under assistance programmes aimed at addressing problems arising as a consequence of preference erosion. The guiding principle should be what is needed in the affected country and the established international practices in most effectively providing support to addressing these needs.[22]

This is vital since the early experience in Cameroon under the SPA demonstrates the centrality of working with economic operators when seeking to enhance competitiveness in a sector affected by preference erosion. Here, despite difficult domestic macro-economic conditions, programmes[23] that were directly co-financed with economic operators in support of their own investment plans, proved very effective in bringing down costs, increasing yields and establishing the basis for an expansion of Cameroonian production and exports to the EU. This assistance could not have been provided speedily had it been linked to broader changes in public policy or other forms of conditionality.

2.7.3 Recognising the problems faced in supporting smallholder farming

However it needs to be recognised that close and effective cooperation in supporting productivity improvements is not always possible, as so much depends on the form of the production system. Particular problems are faced in extending support within smallholder farming systems. Indeed, the experience in the Windward Islands suggests that delivering such support is extremely difficult. Reviewing activities in St Vincent up to December 2004 revealed that only 2.5 percent of funds paid out (€76,557 out of a total of €3.12 million) had been deployed on projects directly relevant to reducing costs and improving the quality of banana production, an amount which represented less than 0.2 percent of the total financial allocation made to St Vincent under the SFA between 1999 and 2005.

Often intermediate structures needed to be established to deliver assistance, but while this may have facilitated the delivery of assistance to small-scale producers, from an administrative perspective, it greatly raised transaction costs. For example, in St Lucia the establishment of a rural-credit scheme to reach out to small-scale farmers resulted in management costs equal to 50 percent of the value of the loans secured, while in St Vincent 26 percent of total expenditures up to December 2004 went on the regional technical-assistance component of the programme.

Reducing delays in the deployment of aid to the final beneficiary and reducing these transaction costs in delivering support, particularly to smallholder farmers, would

appear to be essential if credible programmes of assistance in addressing the challenges of preference erosion are to be established.

2.7.4 Building flexibility into policy responses

EC support programmes in the banana sector illustrate well the need for flexibility in the evolution of the policy response to preference erosion. Under the 1994 SPA to traditional ACP banana producers the focus was on the provision of assistance to enhance competitiveness, implicitly assuming that *all* ACP banana suppliers could be assisted in becoming price competitive, regardless of their underlying cost structures. By 1999, when Windward Island-banana production had already declined by a half, it was recognised that this was not a realistic goal and a more differentiated approach emerged, which sought to take into account the different realities of ACP producers. Five conceptually distinct yet overlapping areas of assistance can be identified:

- support to reducing costs and increasing returns on production from within the sector by enhancing "quality" and more carefully targeted marketing;
- support to the promotion of alternative agricultural products for which markets can be readily identified or developed;
- support to the development of alternative economic sectors so as to address the employment and income consequences of preference erosion;
- support for social safety nets where competitiveness or diversification measures are not sufficient or appropriate;
- support to public-sector management and policy reform.

This five-fold distinction in areas of intervention would appear to have a much broader application, when tackling issues of preference erosion, with each area requiring different tools, procedures and approaches.

2.7.5 Aid deployment – the critical challenge

This leads on to the critical challenge faced in the banana sector (one particularly acutely felt in the Windward Islands), namely the effective delivery of support on the ground to concrete activities. In the case of the Windward Islands there is no shortage of funds for the financing of banana-sector adjustment/diversification measures at the aid-allocation level, but the critical problem is in effectively targeting and deploying the funds that are available. On occasion adjustment measures have become indistinguishable from general development-assistance programmes (be they road infrastructure, a traditional favourite of the EC, or general education, an increasingly favoured area of support).

The difficulties faced are illustrated by the payment rates in the various Windward Islands (see Table 2.6.), with major implementation problems having been faced since 2004 as a result of changes in EC aid procedures.[24] When addressing different aspects of the restructuring challenges thrown up by the processes of preference erosion the sources of these problems need to be identified and appropriate solutions found. Such solutions should place emphasis on the speedy and transparent delivery of carefully targeted support in meeting clear needs and objectives, within a framework of accountable management.

In those areas where it is appropriate (e.g. social adjustment, provision of public infrastructure and establishing the public-policy framework for diversification) public administrations should play a lead role in the design and management of targeted

programmes to address the specific challenges arising from preference erosion. In those areas where it is appropriate (e.g. identifying and managing productivity improvements, implementing cost-reduction measures, identifying new market opportunities and revenue streams, and exploiting opportunities for diversification) industry associations and other industry players should play the lead role. In each instance appropriate instruments of support will need to be set in place and appropriate aid-deployment procedures will need to be established which allow the speedy and effective implementation of the targeted adjustment measures.

Thus overall, one of the key lessons from the SPA/SFA experience is that successful interventions deliver the right mix of investments with minimum delay and low transaction costs.[25] This must be the basic guiding principle for any general programme of support for addressing preference erosion.

3. Preference erosion in the sugar sector: sources and impacts

3.1 The basis of ACP preferences and sources of preference erosion

In order to understand sources of preference erosion in ACP-EU sugar-sector relations it is necessary to understand the different bases on which duty-free access to ACP sugar exports have been granted. The first source of ACP preferential access to the EU market was the sugar protocol, concluded in 1975, at a time of high world sugar prices. It guaranteed sugar supplies to the EU at a negotiated price. It was only with the expansion of EU domestic sugar production, which turned the EU from a large net importer into a large net exporter, that the sugar protocol price came to exceed the sugar price on the world market significantly. With the emergence of Brazil as a major sugar exporter and a depression in world sugar prices, the price differential between EU and world-market sugar prices became huge, generating substantial benefits to preferred ACP suppliers.

Although the sugar protocol was attached to the Lomé Convention and Cotonou Agreement for administrative convenience, it is argued by the ACP that it has a life independent of these wider ACP-EU agreements.

Table 3.1 *Sugar-protocol country quotas (tonnes, raw sugar equivalent)*

Barbados	54,687.4	Jamaica	129,017.4	Swaziland	128,091.8
Belize	43,857.4	Kenya	0	Tanzania	11,071.8
Congo	11,071.8	Madagascar	11,695.7	Trinidad & Tobago	47,555.4
Côte d'Ivoire	11,071.8	Malawi	22,635.2	Zambia	0
Fiji	179,726.4	Mauritius	533,728.3	Zimbabwe	32,853.0
Guyana	173,271.8	St Kitts & Nevis	16,946.6	Total	1,407,283.1

Source: Extracted from the CTA Executive Brief: Sugar table 'Losses by ACP sugar protocol beneficiaries only' at: http://agritrade.cta.int/en/commodities/sugar_sector/executive_brief

The second source of preferential access for ACP sugar exports was the special preferential sugar (SPS) arrangement. This duty-free import scheme was established after the EU enlargement incorporating Portugal and Spain. For some ACP countries, notably Swaziland and Zimbabwe, the SPS arrangement has provided a significant

level of duty-free market access. However the level of access granted under the SPS scheme has always been residual, consisting of the amount required to fulfil the maximum supply needs of EU cane refineries, once all other sources of supply have been taken into account (raw cane-sugar production from EU overseas territories, supplies under the sugar protocol and under EU member states' various MFN commitments).

Table 3.2 *SPS beneficiaries (tonnes, white sugar equivalent)*

Barbados	2,841.2	Jamaica	15,926.8	Swaziland	30,000.0
Belize	4,985.2	Kenya	11,023.4	Tanzania	2,485.9
Congo	2,519.2	Madagascar	2,550.0	Trinidad & Tobago	5,592.2
Cote d'Ivoire	10,000.0	Malawi	10,000.0	Zambia	12,731.5
Fiji	19,181.8	Mauritius	41.980.1	Zimbabwe	25,000.0
Guyana	19,931.7	St Kitts & Nevis	1,831.3	Total	215,580.3

Source: Extracted from the CTA Executive Brief: Sugar table 'SPS Quota' at: http://agritrade.cta.int/en/commodities/sugar_sector/executive_brief

Since 2001 sugar supplied under the progressively expanding quota granted under the EU's EBA initiative in favour of LDCs (the bulk of whose beneficiaries are ACP countries) had also to be taken into account, progressively reducing the level of SPS access available to countries such as Swaziland and Zimbabwe.

Market access under the EBA is the third source of preferential access for certain ACP sugar exporters (i.e. the least-developed ACP countries). Ironically the unilateral introduction of EBA sugar preferences constituted the first area of preference erosion for traditional ACP sugar suppliers, in this case arising from preferences being granted to LDCs which were mainly ACP countries themselves.

Box 3.1 *Recent investment and production trends in southern African LDCs*

The impact of EBA market access

In Mozambique there has been a major increase in investment by the South African-based sugar companies Illovo and Tongaat-Hulett, and significant investment from Mauritian sugar interests in Sena Sugar**.** Production has risen from 44,000 tonnes in 1999 to 265,000 tonnes in 2005, with Mozambique exporting the highest volume of sugar since independence at 175,837 tonnes in 2006. Production is expected to reach 292,000 tonnes in 2007 and around 500,000 tonnes by 2012.

Illovo has also been a major investor, with total Zambian sugar production in 2006 reaching over 250,000 tonnes, up from 186,000 tonnes in 1999. In 2006 Zambia exported 38,500 tonnes of sugar to the EU (11,000 tonnes under the EBA), including 7,215 tonnes of speciality Demerara sugar.[26] Overall press reports indicate that sugar companies in Zambia are planning to expand sugar production from 255,000 tonnes to 434,000 tonnes by 2010, with exports to the EU increasing from 38,000 tonnes to 229,000 tonnes. In addition recent press reports indicate interest from Spanish and

Indian investors in developing a plantation with a capacity to produce a further 250,000 tonnes of sugar.[27]

In Malawi, where Illovo is the sole miller, production has expanded from 207,801 tonnes in 2001 to 256,706 tonnes in 2005, when 43,000 tonnes were sold into the EU market. Investment has also been made in developing speciality sugars for export to the EU. In 2006 it was anticipated that Malawi would export 23,000 tonnes to the EU under the sugar protocol and 21,027 tonnes under the EBA initiative. Maximum production capacity in Malawi is estimated at 280,000 tonnes.

In Tanzania, where Illovo and a combination of Mauritian and French investors are interested in developing production, it is envisaged that production will increase from 270,000 in 2006 to 440,000 tonnes in 2010 (following rapid growth after 1999, when production was only 108,000 tonnes). While much of this envisaged extra production could be absorbed internally to replace the 200,000 tonnes of sugar currently imported, profit maximisation across what is increasingly a regional industry are likely to mean that a growing volume will be exported to the EU under the EBA.

Even as far north as Ethiopia the government has announced plans to expand sugar production from 280,000 tonnes to 1 million tonnes, although to date no firm foreign private-sector investor has been mobilised in the realisation of these plans. Similar ambitious plans have been announced in the Sudan.

The impact of the EBA however has implications for non-LDC ACP sugar suppliers way beyond the erosion of access under the SPS arrangement. By introducing duty-free, quota-free access for LDC sugar exports from 2009, the EU EBA initiative has had a profound impact on patterns of private investment in the sugar sector, particularly (but by no means exclusively[28]) in eastern and southern Africa. There has in recent years been a major upsurge in private investment in sugar production in the LDCs of southern and eastern Africa. Illovo alone plans to expand its sugar production outside of South Africa by 305,000 tonnes after 2010 at a cost of R825 million. This is on top of the expansion which has already taken place since 2000.

Meanwhile non-LDC Swaziland continues to face quota-restricted access to the EU market and is largely missing out on this investment surge currently underway in the southern and eastern African sugar sector, with production growth in Swaziland largely being driven by government-supported smallholder schemes, rather than estate-based production, and out-grower schemes financed by private companies.

The existence of the EBA initiative affects not only patterns of investment in sugar production but also patterns of investment in value-addition activities, with investments in the development of speciality sugars taking place in Zambia and Malawi. This type of investment in value-added speciality sugars has long-term implications as the process of preference erosion in the sugar sector gathers pace, and the additional value obtainable on EU raw-sugar markets progressively disappears.

Box 3.2 *An investor's view*

"…because we will be able to supply duty-free into the EU and that does give us a good basis for expansion projects because it is not that often that you get a good opportunity to expand your business against known prices … by 2009 in respect of the LDCs in which four of our operations work, that is Malawi, Mozambique,

Tanzania and Zambia, will have duty-free access and therefore we would be able to supply whatever tonnage we make into the EU at a particular laid-down price which is the bulk price. But we are hoping to be able to add value to that by producing specials or refining the sugar, so that we can in fact, share in the value chain within the EU as well."

Don Macleod, Chief Executive Officer, Illovo, 17 November 2006.

The impact of preference erosion on private-sector investment flows into the affected sector is an area that is commonly neglected in considering adjustment needs and associated public policy responses. It is however an area that requires specific attention, both in determining appropriate trade-policy responses and establishing appropriate financial-support instruments.

Table 3.3 *EBA (tonnes, white sugar equivalent)*

Year	Tariff-quota (tonnes)	Of which ACP
2001-2002	74,185	74,185
2002-2003	85,313	76,343
2003-2004	98,110	89,443
2004-2005	112,827	103,829
2005-2006	129,751	129,751
2006-2007	149,213	n/a
2007-2008	171,595	n/a
2008-2009	197,335	n/a

Source: Extracted from table 'Deliveries of EBA Sugar to the EU' at http://www.ldcsugar.org/

In addition to its impact on investment the full implementation of EBA duty-free access is likely to increase competition between non-LDC ACP suppliers and LDC suppliers, even in a context of continued tariff protection against non-ACP and non-LDC suppliers. Production growth in Mozambique, Zambia, Malawi and Tanzania alone could generate a further 600,000 tonnes of production, much of which could be directed to the EU market. Plans for production growth in Ethiopia and Sudan, if ever realised, could double or even triple the available sugar for export to the EU.[29] This is likely to lead to considerable price competition between low-cost LDC suppliers and non-LDC sugar-protocol suppliers. While this is likely to be limited by corporate profit maximisation concerns (with investments in exploiting refined sugar and speciality sugar markets under the EBA appearing to be a significant trend[30]), it will nevertheless be a factor in the erosion of the value of ACP sugar preferences traditionally enjoyed under the sugar protocol.

3.2 Where are we in preference erosion in the sugar sector?

Currently the principal source of ACP preference erosion in the sugar sector is the process of CAP reform. Although many argue that this is a result of the outcome of the WTO dispute-settlement process around the challenge to aspects of the EU sugar regime, this is to neglect the history of CAP reform. As early as 1993 the EC had been

seeking to extend the reforms introduced in the cereals sector to the sugar sector. The initial proposal was for an uncompensated 25 percent price reduction.[31] A successful lobby by the EU sugar-farming and sugar-processing industry of member-state governments effectively blocked these moves in 1994 and again in 2000 and 2003, with a round of sugar-sector reform only being agreed in 2005.

Box 3.3 *The WTO sugar dispute*

Five WTO members, Brazil, Australia, Colombia, Guatemala and Thailand filed a complaint at the WTO challenging two aspects of the EU sugar regime: the cross-subsidisation of 'C' sugar exports from the high administratively established prices paid for 'A' and 'B' sugar; and the failure to include the 1.6 million tonnes of sugar nominally re-exported in the notification to the WTO of export subsidies.

In September 2004 the WTO panel found against the EU on both counts. The EU appealed against the decision and in May 2005 the dispute settlement board adopted a report upholding the initial ruling. The EC stated its intention to comply within a reasonable time period; in August 2005 the complaining parties requested an arbitrator to determine what a reasonable time period would be. In October 2005 the arbitrator ruled on this point requiring the EU to end the practices against which the complaint had been upheld by 22 May 2006.

As a consequence, EU sugar exports will in future be limited to the 1.3 million tonnes notified to the WTO.

The EC's success in 2005 in finally persuading EU member states to bite the bullet of sugar-sector reform was largely attributable to the market dynamics set in train by the unilateral granting of unrestricted access to the EU market for LDC sugar exports from 2009, and the success of the WTO sugar dispute-settlement case in challenging the cross-subsidisation of sugar exports implicit in the high 'A' and 'B' quota prices maintained in the internal EU market.

Certainly the WTO case allowed the EC to push through a more extensive process of price reductions in a single step, than would have otherwise been the case. However the principal motivation for the 2005 sugar-sector reforms lay in the underlying logic of the process of CAP reform.

Box 3.4 *The EU sugar-sector reforms*[32]

The reform of the EU sugar regime, although introducing some major changes also maintains some important feature of the old regime, notably:

- prices are still established administratively rather than by the market, (although they will be 36 percent lower within four years);
- there will still be quota limits on production;
- a system of levies will remain in place, although this is now to finance industry restructuring not exports;
- intervention buying will remain in place for four years, before being replaced by a floor price and support for private storage;
- a regulated import regime will remain in place;
- exports will now be in line with the EU's WTO export obligations.

New elements have however been introduced, notably:

- direct aid payments to EU sugar-beet farmers to compensate for the reductions in the sugar price;
- a "voluntary" restructuring scheme for beet processors wishing to leave the industry;
- provision for the use of non-quota sugar in the chemical, pharmaceutical and bio-fuel industries.

In November 2005 the following specific measures were introduced:

- a reduction in the guaranteed price for white sugar of 36 percent over four years, beginning in the 2006/07 season;
- the introduction of decoupled payments equivalent to "64.2 percent of the price cut" and "cross compliance";
- the payment of an additional "coupled payment" equivalent to 30 percent of the price cut for five years, plus the possible payment of "limited national aid", where more than half their production quota is given up;
- the establishment of a "voluntary" four-year restructuring scheme for EU sugar factories and isoglucose and inulin producers, to: "encourage less competitive producers to leave the industry" (payments will be €730 per tonne in the first two years, falling to €625 in year three and €520 in year four);
- the funding of restructuring measures through a special levy placed on remaining quota holders over three years of the transition;
- the introduction of scope to use restructuring funds to compensate beet producers affected by factory closures (reportedly up to 10 percent of the amount);
- the establishment of a "diversification fund for member states where the quota taken up is reduced by a minimum amount, with diversification funds increasing the more quota is renounced";
- the merging of the 'A' and 'B' quotas;
- the allocation of an additional quota of 1.1 million tonnes to 'C' sugar-producing countries against "a one-off payment corresponding to the amount of restructuring aid per tonne in the first year";
- an increase in the isoglucose quota of 300,000 tonnes for existing companies, phased-in over three years;
- the possible purchase by Italy (60,000 tonnes), Sweden (35,000 tonnes) and Lithuania (8,000 tonnes) of extra isoglucose quota at the restructuring aid price.

3.3 Prospects for substantial tariff liberalisation of the sugar sector

Outside of the EBA framework, where a firm commitment to full quota-free and duty-free access has been made, and possibly the forthcoming economic partnership agreements (EPAs) with regional groupings of ACP countries, it is highly unlikely that the EU will agree to substantial tariff liberalisation in the sugar sector (either bilaterally or multilaterally), without a further substantial round of price reductions in the EU sugar sector. This is unlikely to take place before 2013. However, should the gap between EU sugar prices and world market prices be further closed, there would be scope for a process of dismantling tariffs around the EU sugar market.[33]

It needs however to be recognised that the current process of EU sugar-sector reform is facing a number of difficulties. The first problem arises from the limited take-up of restructuring aid, with funds for only 1.5 million tonnes instead of 6 million tonnes being taken up. As a consequence the EU is facing a sugar surplus of about 4.5 million tonnes in the coming years, against the backdrop of very real WTO constraints on export volumes. Accordingly the Agriculture Commissioner Fischer Boel has warned the European sugar industry that the EC will not "bail out the industry" and has urged it to take up its responsibilities. If it did not, then compulsory linear quota cuts would need to be introduced.[34] Indeed in February 2007 initial steps were taken to introduce a cut of 2 million tonnes in the EU sugar quota for 2007/08.

In this difficult EU market context, even the prospects for non-LDC ACP sugar exporters securing an expansion of duty-free access under any EPA agreements is looking more difficult, never mind securing EU agreement to any substantial tariff reductions at a multilateral or bilateral level where competitive sugar producers are involved. Indeed, the emerging market situation in the EU may lead to calls for steps to be taken to limit the rate of growth in LDC sugar exports to the EU once duty-free and quota-free access becomes available under the EBA from 2009. This being said, new developments in the ethanol market could offer one way of disposing of the accumulating EU sugar surpluses, with sugar stocks being directed towards production of ethanol, for which demand in the EU is expanding.[35]

However, the current difficulties being faced in terms of the take up of voluntary restructuring aid could pale into insignificance if current attempts in the Czech Republic to challenge the legality of corporate sales of national sugar quotas back to the EC are successful.[36] If this were to succeed the uncertainty it would generate could undermine the EC's chosen "voluntary" approach to sugar-sector restructuring. This in turn would be likely to generate substantial pressures to restrict further liberalisation of EU sugar markets in the short to medium term.

Box 3.5 *Internal EU sugar-sector restructuring support*

To encourage the "voluntary" giving-up of sugar-production quotas in the least-favoured areas for sugar production the EU has established a temporary restructuring fund. This fund will be made up of money raised through a levy on remaining sugar producers. It is expected to yield €7 billion over the three seasons from 2006–2009. Restructuring aid will be paid on a decreasing scale to producers renouncing their quota either fully or partially, dismantling their factory or using it for non-sugar purposes. A minimum of 10 percent of the restructuring aid is to be reserved for payments to beet growers and machinery suppliers affected by the measure. Those applying for restructuring support will receive 40 percent of funding in June of the season in which they are giving up the quota and 60 percent in the following February, provided sufficient funding is available within the restructuring fund.

Table 3.4 *Restructuring payments (per tonne)*

Year	Renounce quota, full factory-closure	Renounce quota, partial factory-closure	Renounce quota, use factory for non-sugar purposes
2006/07	€730.00	€547.00	€255.50
2007/08	€730.00	€547.00	€255.50
2008/09	€625.00	€468.75	€218.75
2009/10	€520.00	€390.00	€182.00

Source: Extracted from Council Regulation (EC) No. 230/2006 of 20th February 2006, establishing a temporary scheme for the restructuring of the sugar industry in the Community and amending Regulation (EC) no. 1290/2005 on the financing of the common agricultural policy, Official journal of the European Union L 58/42, 28.02.2006, at:

http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_058/l_05820060228en00420050.pdf

In addition funds are made available to member states to support diversification in areas being taken out of sugar production. The amount of funding made available for diversification varies according to the level of national quota being renounced. For member states giving up quota, 40 percent of funding will be made available in June of the season in which they are giving up the quota and 60 percent the following February, provided sufficient funding is available within the restructuring fund.

Table 3.5 *Diversification payments (per tonne)*

Year	Renounce below 50% of national quota	Renounce between 50% and 75% of national quota	Renounce between 75% and 100% of national quota	Renounce 100% of national quota
2006/07	€109.50	€164.00	€191.25	€219.00
2007/08	€109.50	€164.00	€191.25	€219.00
2008/09	€93.80	€139.70	€163.15	€187.60
2009/10	€78.00	€107.00	€126.50	€156.00

Source: Extracted from Council Regulation (EC) No. 230/2006 of 20th February 2006, establishing a temporary scheme for the restructuring of the sugar industry in the Community and amending Regulation (EC) no. 1290/2005 on the financing of the common agricultural policy, Official journal of the European Union L 58/42, 28.02.2006, at:

http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_058/l_05820060228en00420050.pdf

Other transitional funds for restructuring are available, totalling €164 million for specific member states to deal with particular problems.

In addition to these payments sugar-beet farmers are of course to receive direct aid payments under the single farm payment scheme equivalent to 64.2 percent of the price cut.

3.4 Prospects for tariff reductions in sugar-containing value-added products

Prospects for tariff reductions on certain sugar-containing products appear somewhat different. Currently, the EU operates a sophisticated system of duties and special duties on value-added products containing CAP-covered agricultural raw materials. The special duties charged on sugar-containing products are particularly onerous. Under this system of special duties, levies are charged on the sugar content of value-added food products based on the sugar content of the product. This effectively restricts trade in sugar-containing value-added food products where sugar constitutes a significant input in volume terms. In this context for these products there is more scope for the negotiation of tariff reductions in the light of the EU's new free-trade-area policy.

This is also the case with regard to ethanol, where the deficit in EU ethanol production in the light of planned targets for ethanol usage in transportation fuel (up from the non-binding target of 2 percent in 2005 and 5.75 percent by 2010[37] to a binding target of 10 percent of transport fuels by 2020) along with the commitment to ensure diversified sources of overseas supply and maintaining a "regulated market approach"[38] to bio-fuel development, offers considerable scope for the negotiation of tariff concession on ethanol for a range of potential ethanol suppliers. The EC's commitment to a "regulated market approach" to bio-fuel development implicitly rules out the possibility of across-the-board tariff elimination in this sector.

Under its new free-trade-area policy the EC is increasingly looking to secure agreements on "behind border" issues. The kind of "behind border" issues which it wants to see addressed include "poor protection of intellectual property rights and patents. Closed markets for services and investment. Unfair state intervention which distorts prices and fair competition. Public-procurement markets that remain closed to fair competition."[39] Since these policies affect areas in which the EU is felt to be strong and competitive, a far more aggressive approach to securing liberalisation in these areas is now to be pursued. However, the question arises: what can the EU offer advanced developing countries in exchange for agreements on "behind border" issues?

The obvious answer is improved access to EU agricultural, food-product and agriculture-based raw-material markets. Illustrative of this was the EC announcement at the beginning of 2007 that it proposed to start talks with Egypt on "liberalisation of agricultural trade", with the aim of concluding an "ambitious" free-trade area by 2010. Mandates for similar negotiations with Asian and central American countries and for breathing life back into the Mercosur negotiations have been sought or are expected. Certainly in the case of Mercosur and central American countries, securing improved market access for sugar exports is likely to be accorded high priority in the negotiating agendas. Since the EU has little scope for direct concessions in raw or refined sugar products given the problems faced on EU sugar markets, the obvious policy response is to offer concession on duty-free access for ethanol (where the EU has a structural deficit and where tariff-rate quotas could be front-loaded) and on sugar-containing food products, particularly those with strong linkages to other agricultural sectors on which tariff concessions are being considered (e.g. canned fruit).

Such an evolution of tariffs for sugar-based food products through the negotiation of bilateral EU free-trade-area agreements would serve to narrow the scope for trade

responses to the erosion of the value of traditional ACP preferences in the sugar sector, based on support for product diversification within the sugar sector and the adoption of value-addition strategies to reduce transportation costs and vulnerabilities to declining prices of basic commodities. This would occur since tariff concessions on ethanol and sugar-based food products to non-ACP suppliers would increase competition on the EU market at a time when ACP producers were seeking to penetrate these markets for ethanol and sugar-based value-added products. This could create a situation of price declines in a context where the costs of capital investment had not yet been recovered. This could create financial difficulties, unless the investment was financially structured in such a way as to take into account the likely price declines.[40]

Thus we can see that appropriate policy responses to preference erosion in the sugar sector will be heavily influenced by the source of preference erosion at each stage of the preference-erosion process and the likely evolution of the process of preference erosion in the short and medium term.

This provides the context within which policy responses to preference erosion in the ACP-EU sugar-sector relationship will need to be addressed.

Box 3.6 *The likely evolution of preference erosion in the sugar sector*

Developments relating to preference erosion in the sugar sector are likely to take the following path:

- full implementation of agreed reforms in terms of a 36 percent price reduction between 2006-2010;
- discussion of a further round of sugar-sector reforms as part of the 2007/08 "health check" of the CAP;
- implementation of a further round of sugar-sector reforms from 2013 in an effort to further close the gap between EU and world-market sugar prices;
- the possible inclusion of tariff-reduction commitments on a tariff-rate quota basis for certain specified sugar-based products in EU bilateral free-trade-area agreements (with a front-loading of ethanol commitments and a gradual phasing-down of tariffs on other sugar-containing food products, with full tariff elimination being back loaded until after the implementation of the 2013 round of EU sugar-price reductions).

3.5 The EU response to preference erosion in the sugar sector

In February 2005 the EC issued a working document on the "Action plan on accompanying measures for sugar protocol countries affected by the reform of the EU sugar regime", setting out how it intended to assist ACP countries in adjusting to the new market conditions created by EU sugar-sector reform. There were two distinct components to the EU response strategy:

- a trade component;
- a financial-assistance component.

In formulating appropriate country responses considerable emphasis was placed on assessing the future prospects of each ACP sugar sector in the context of lower EU

prices and the underlying cost structure of the local sugar industry. A clear position was taken that where "directing assistance towards maintaining the sugar industry would not be sustainable in the long term, and would correspond to an inefficient use of financial resources, the EU favours supporting diversification or broader adjustment measures". This was a clear effort to learn from the earlier 1994 special programme of assistance (SPA) for ACP banana producers. Following the model of the 1999 special framework of assistance (SFA) for ACP banana producers the foundation for the deployment of the financial assistance was to be a national adaptation strategy, setting out the short-, medium- and long-term perspectives for the sugar sector and setting the proposed measures in the wider national and international context.

In terms of the trade component, the EU emphasised the importance of trade policy, as is being elaborated both in an EPA and WTO context. It implicitly envisaged four components to this trade-policy response:

- further EU market opening in the sugar sector;
- further EU marketing opening in other product areas;
- development of regional markets for sugar and sugar products;
- the pursuit of the "right policy framework"[41] in an EPA and WTO context.

With regard to the issue of further EU market opening, Trade Commissioner Peter Mandelson spoke extensively in the Caribbean in January 2005 about improving market access to compensate for price declines. In addition the use of expanded market access as part of the EU's policy response to supporting competitive low-cost ACP sugar suppliers in adjusting to the consequences of EU sugar-sector reform was extensively discussed during discussions under the UK presidency of the EU Council.

In terms of the development-assistance component of the EU policy response, three main axes of assistance were identified:

- the enhancement of competitiveness;
- the promotion of diversification;
- support to broader adjustment processes, including addressing the short- to medium-term social impacts and the establishment of well-targeted safety nets.

Clearly the approach to the development-assistance response tried to build on the lessons of the SFA for ACP banana producers. However the tendency to classify countries according to whether they could attain competitiveness, needed to diversify or required social-adjustment support in coping with the impact of preference erosion appears to have led the EC away from recognising that individual ACP sugar-producing countries may have need of *all* of these types of support: support to enhance competitiveness; support for diversification for some of its sugar producers; and support for social adjustments for those adversely affected by industry-led response measures. All these forms of support are certainly required in one low-cost ACP sugar producer, Swaziland (see the case study below).

In terms of funding and delivery of assistance the EC favoured extending assistance to country-specific sugar-adjustment strategies in the form of non-targeted budgetary support or through support to sector-wide approaches. A traditional project-based

approach, while not ruled out, was felt to impose too heavy a management burden on the EC.

Given the diversity in the ACP group with regard to competitiveness in sugar production, the logical starting point for reviewing the impact of preference erosion is a categorisation of the underlying competitive positions of different ACP suppliers. This was attempted by Landell Mill Consultancy (LMC) for the UK Department for International Development in 2003, with ACP countries being divided into three distinct groups:

- those where sugar production remains profitable after EU reforms;[42]
- those where sugar-sector restructuring is necessary, but profitable production can be attained following EU reforms**;**
- those with sugar industries that do not have a profitable future after EU sugar-sector reforms.

This approach was implicitly taken over by the EC, causing a storm of protest, particularly from governments of those countries classified as not having a profitable future in sugar, since this implied industry closure, a course of action seen as being "political suicide". This highlights one of the immediate challenges in identifying the impact and appropriate policy response to preference erosion, namely, the very politically sensitive nature of this process.

It also highlights the practical difficulty of making such assessments at a time of dynamic technological change and widely fluctuating prices on markets which have a bearing on "market prices" for sugar.

Overall the experience of the EC response to preference erosion in the sugar sector to date suggest a need for:

- the establishment of easily and rapidly accessible adjustment-support instruments, to respond to the challenge of preference erosion;
- the establishment of simple procedures for the deployment of support to restructuring initiatives;
- the need for flexible instruments which are permissive but not prescriptive in determining the appropriate policy response;
- the need for instruments which share risks through "own resource" deployment so that private-sector operators are encouraged to undertake thorough analysis of adjustment proposals before submitting them for support.

Box 3.7 *The scope of the EC development-assistance response*

The February 2005 EC working document elaborated on the types of measures which could be supported. With regard to improving competitiveness, areas of support identified included:

- improving technology and management in the field;
- restructuring production structures;
- developing other sugar-cane-related products to open up new revenue streams;
- implementing codes of corporate best practice;
- improving environmental management;
- adapting the policy and institutional context;
- improving research and extension;
- developing service infrastructure;
- improving access to finance;
- macro-economic support.

With regard to diversification, emphasis was placed on identifying "a pro-poor diversification strategy", including:

- ensuring that "the identification of market opportunities" is the driving force in the diversification strategy;
- ensuring that a comprehensive sectoral strategy is adopted in developing alternative economic activities, taking into account: "all levels of the chain and the diversity of enterprises at a given level; the complementary roles of both the private and public sector; and all factors which influence the diversification potential";
- the adoption of measures to reduce market risk in sectors chosen for diversification;
- ensuring that a long-term perspective is adopted.

In terms of support for broader processes of economic and social adjustment, it was stressed that national adaptation strategies should seek to carefully target safety-net measures and other programmes geared towards dealing with the social costs of the adjustment processes. Explicit reference was made to supporting governments in taking over the management and financing of former industry-run facilities, where the provision of such facilities was adversely affected by EU sugar-sector reforms.

3.6 The impact of EU sugar-sector reform

The most important impact of EU sugar-sector reform is on the price paid for ACP sugar, with the raw-sugar price falling from €523.7 per tonne to €496.8 per tonne in the 2006/08 seasons, to €434.1 per tonne in the 2008/09 season and to €335 per tonne from 2009/10 onwards.

Table 3.6 *Changes in prices for ACP raw sugar*

Year	Price per tonne	% change (cumulative)
Current regime	€523.7	0
2006/07	€496.8	- 5.1%
2007/08	€496.8	- 5.1%
2008/09	€434.1	-17.1%
2009/10	€335.0	-36.0%

Source: See table 'Changes in prices for ACP sugar' in CTA Executive Brief: Sugar at: http://agritrade.cta.int/en/commodities/sugar_sector/executive_brief

In the first two years of reform the only price cut that ACP suppliers face will be that equivalent to the loss of the refining aid formerly paid from the EU budget to EU cane refiners. However the ACP as a whole will face income losses of over €265.5 million per annum from 2009/10 onwards under the sugar protocol alone. Additional losses will occur under the replacement for the SPS regime and the EBA regime, amounting to around €32.4 million per annum from 2009/10 onwards.

Table 3.7 *Losses on ACP sugar-protocol earnings from final agreed EU sugar reforms*

Year	Raw price (€/tonne)	Tonnage (raw-sugar equivalent)	Earnings (€)	Losses (€)
2005/06	523.7	1,407,283	736,993,890	0
2006/07	496.8	1,407,283	699,137,990	- 37,855,900
2007/08	496.8	1,407,283	699,137,990	- 37,855,900
2008/09	434.1	1,407,283	610,901,370	- 126,092,520
2009/10	335.0	1,407,283	471,439,670	- 265,554,220
Total 2006-2010				- 467,358,540

Source: See table 'Losses on ACP sugar protocol earnings form the final agreed EU sugar reforms' in CTA Executive Brief: Sugar at: http://agritrade.cta.int/en/commodities/sugar_sector/executive_brief

The income losses in descending order of total annual loss in income from 2009/10 is set out in Table 3.8. It should be noted that only nine countries have income losses under the sugar protocol in excess of €5 million and only in Mauritius, Fiji, Guyana, Swaziland and Jamaica[43] does the sugar sector play a major role in the national economy.

Table 3.8 *Annual losses under the sugar protocol from 2009/10 (€ millions)*

Country	Loss	Country	Loss	Country	Loss
Mauritius	-100.7	Fiji	-33.9	Guyana	-23.7
Jamaica	- 24.3	Swaziland	-24.1	Barbados	-10.3
Trinidad	- 9.0	Belize	- 8.3	Zimbabwe	- 6.2
Malawi*	- 4.3	St Kitts & Nevis	- 3.2	Madagascar*	- 2.2
Tanzania*	- 2.1	Congo*	- 2.1	Côte d'Ivoire	- 2.1
Kenya	-	Zambia*	-		

Source: Extracted from table 'Losses by ACP sugar protocol beneficiaries only' in CTA Executive Brief: Sugar at: http://agritrade.cta.int/en/commodities/sugar_sector/executive_brief

The impact of the income losses from preference erosion in the sugar sector is thus concentrated in only a limited number of countries, leading the EU Trade Commissioner to conclude that this is an issue which it should be relatively easy to address through either trade or aid instruments. However, moving forward with an operational programme to address problems of preference erosion in the worst-affected countries is proving much more difficult than he envisaged.

Why this is the case can be seen from the multiplicity of impacts that can follow from income losses on sales to the EU market on the ground, and the ripple effects that can impact on vulnerable single-commodity-dependent economies. This can best be illustrated by looking at the case of Swaziland, where currency movements between 2002 and 2005 generated income-loss effects on sugar sales to the EU in local currency which closely approximate the income losses that will arise as a result of the scheduled 36 percent reduction in the price paid by EU refiners for ACP raw sugar. The 37 percent loss of revenues in local currency arising from the currency movements has had some very dramatic effects on both the sugar sector and the wider economy, effects which provide clear insights into the likely impact of a 36 percent reduction in the EU raw sugar price paid to ACP suppliers.

3.7 The impact of EU sugar reform: the indicative case of Swaziland

Seven major effects can be identified as following from the 37 percent[44] decline in local-currency earnings on sugar sales to the EU as discussed in the following seven subsections.

Box 3.8 *Why Swaziland provides an ideal case study of the impact of EU sugar-sector reforms*

Swaziland provides an ideal case study of the impact on domestic sugar sectors of income losses arising from EU sugar-sector reform. This is because of the similarity that exists between the impact of currency movements that occurred between 2002 and 2005 on local currency earnings on Swazi sugar sales to the EU, and the scale of revenue losses in the sugar industry that will arise as a result of the implementation of EU sugar-sector reforms, involving a 36 percent reduction in the price paid by EU refiners for ACP raw sugar. From 2002 to 2005 the appreciation of the South African rand (to which the Swazi currency is tied) against the euro, meant that the income

earned on Swazi sugar exports to the EU fell by 37 percent, only slightly more than the planned EU price reductions. Over this period restructuring measures were initiated to adjust to this dramatically changed revenue position, and this experience thus provides insights into the likely impact of EU sugar-sector reform on ACP economies.

3.7.1 The income effect on industry

The first effect was to exert a strong downward pressure on the sucrose price paid to farmers. This arose as a result of the relatively high dependence on exports to the EU market (35 percent of total sugar-industry revenue). Given the revenue-sharing arrangement in place in Swaziland[45] this served to reduce the profitability of both sugar-farming and sugar-milling operations. This created particular problems on newly established smallholder sugar farms, where investment costs had not yet been repaid and price falls coincided with high capital repayment obligations. This has important implications for the relationship between the deployment of restructuring support and the phasing-in of the impact of preference erosion.

3.7.2 The employment and social-welfare effect

The second major effect was to increase pressure for cost savings in the industry, this led to large-scale job losses (in Swaziland the retrenchment of 30 percent of the workforce) and out-sourcing of major activities which undermined working conditions and labour rights. It also led to a unilateral reduction of social expenditures by sugar-sector companies, including on education and health provision in sugar-growing areas and the initiation of steps to disengage from provision of public utilities in sugar-growing areas. These developments, if left unaddressed can serve to increase social and political tensions, which make attracting new investment in economic diversification more difficult.

3.7.3 Impact on the wider rural economy

The third major effect was the knock-on effects of sugar-industry losses on demand for goods and serves, both within the industry (in an effort to reduce costs) and in the wider rural economy. It can generate considerable pressures on the suppliers of good and services to reduce prices and increase their efficiency. Depending on the importance of the sugar sector to the local economy this can create a need for quick-disbursing public investments in the affected areas to counter the local deflationary effects of declining sugar-sector earnings.

3.7.4 The effects on innovation and competitive stimulation

The fourth major effect was on innovation at the field and factory level in an effort to reduce costs. This of course is the kind of response that liberalisation is intended to bring about. In Swaziland this has been private-sector-led and is focussing on the introduction of innovations to reduce operating costs (e.g. by electricity co-generation using cane waste and improving the efficiency of haulage operations from field to factory) and opening up new revenue streams (bio-fuels).

3.7.5 Encouraging movement up the value chain

A fifth major effect was to encourage movement up the sugar-value chain to reduce corporate vulnerability to declines in sucrose and raw-sugar prices. This is underway to a limited extent in Swaziland, with different companies adopting different options.

This represents another of the positive dimensions which liberalisation is intended to stimulate.

3.7.6 Impact on government revenues and expenditure patterns

The sixth major effect was on government revenues derived from the sugar sector, including from industry-specific taxes, corporate taxes and personal taxation. This came at a time when income losses were leading sugar-sector companies to disengage from the financing of health, education, housing, social welfare and public utility provision in sugar-producing areas. This can create a situation of increased demand for government spending at the same time as government revenues are coming under strain. Alternatively of course it can lead to reduced access to education, health and housing provision for both remaining and retrenched workers.

3.7.7 Impact on the financial sector

The seventh and final area of impact of the 37 percent decline in local-currency earnings on sugar sales to the EU was on the financial sector. In an effort to support smallholder sugar development the local banking sector had become heavily exposed to sugar-sector lending. The dramatic fall in sucrose prices following reduced earnings on exports to the EU left newly established smallholder sugar farmers unable to service both their seasonal loans and capital loans. This has created a situation of escalating indebtedness amongst newly established smallholder sugar farmers, and left the banks with a large number of non-performing loans. Given their high exposure to sugar-sector lending this is threatening serious financial instability. Addressing the financial situation of smallholders is seen as essential in Swaziland since any attempt to improve agronomic practices and farm management will yield few benefits if the principal beneficiary of such innovation is not the farmer but the financial institutions to which the farmer is in debt. Addressing issues of financial restructuring can thus be seen as central to wider processes of innovation in response to the erosion of the value of traditional trade preferences.

3.8 Policy responses: the lessons from the Swazi experience

3.8.1 Policy response: addressing the income effect

Given the source of current preference erosion in the sugar sector, in a context of the considerable additional value to be had on the EU market compared to other markets (even after the implementation of the 2005 reforms), the first and most directly effective policy response for low-cost non-LDC[46] ACP sugar producers such as Swaziland, is to grant immediate additional duty-free access to the EU market. Depending on the level of additional access granted this could make a major contribution to reducing the income losses arising from a 36 percent reduction in the EU sugar price For example were Swaziland to be allowed to expand its sugar exports to the EU by 215,000 tonnes by expanding production and redirecting sugar currently sold at world market prices to the EU, this would largely balance the impact of the planned price reductions.

Of course such a policy response is only possible where EU price declines are administratively determined and access to the EU market is strictly controlled. Were price reductions to be driven by a process of comprehensive tariff dismantling (which is not the case in the sugar sector at the moment) then such a policy response would not be possible.

3.8.2 Policy response: addressing the employment and social effects

As the Swazi experience clearly demonstrates, even in a low-cost sugar-producing country the erosion of the value of preferences driven by CAP reform, as experienced in the sugar sector, can have serious social consequences. Unless social effects are addressed, joblessness, homelessness and hopelessness can come to characterise the affected communities and regions, leading to a downward cycle which can be very hard to reverse. If a climate is to be created for private-sector investment in diversification then these social effects need to be addressed, including the establishment of retraining programmes for retrenched workers and public-works programmes to improve local infrastructure and maintain the "work ethic" in the affected communities.

3.8.3 Policy response: supporting innovation and cost reduction

Promoting innovation and cost reduction is one of the theoretical benefits of increased competition. However, in many ACP countries the necessary human and technical resources for successfully driving a process of cost savings and innovation are not always locally available.[47] Where this is the case and such a response is not automatic there is a need for policy instruments to support the process of innovation and cost reduction. Targeted instruments will be required to support a process of technical innovation to improve productivity at field, milling and refining levels and to support the development of other sources of revenue from sugar-cane production (electricity co-generation and ethanol production). This constitutes a major policy area for formulating appropriate responses to preference erosion. Commonly governments are designated as the intermediate body for the delivery of this assistance. Yet public aid administrations in ACP countries often have no real history of engagement with private-sector bodies in designing and implementing major sectoral restructuring programmes. This can lead to serious problems in the design and delivery of support to production innovation and modernisation. A clear lesson from the EU's banana experience is that the closer the design and implementation of response measures for production innovation are to the producers concerned the more effective is the support.

3.8.4 Policy response: addressing the effects on the wider rural economy

Closely linked to the social effect is the effect on the wider rural economy. It is not only the sugar sector that is affected but all those sectors providing inputs and goods and services to the sugar sector and living off incomes generated by the sugar sector.

An important priority needs to be to find ways of delivering assistance in addressing the various problems arising as a consequences of preference erosion in ways that maintain demand for goods and services within the wider rural economy. An obvious vehicle for this is labour-intensive public works. A further vehicle is the establishment of low-cost loan or grant facilities to support the development of new agricultural activities in the affected regions or the establishment of programmes in support of small- and micro-enterprise development, involving both the extension of financial assistance and provision of support services to business.

The important point is to find the means of rapidly injecting cash into the affected regions to counter the deflationary effects of the contraction of demand for goods and services from the sugar sector resulting from large-scale income losses to the sugar sector.

3.8.5 Policy response: supporting movement up the value chain

Movement up the value chain is not always an automatic response to preference erosion. In many ACP sugar-exporting countries major structural impediments to effective competitive engagement with the world economy are faced (be they remote island nations or land-locked economies with high rates of HIV/AIDS infection) and this can make investment in moving up the value chain by no means the obvious private-sector response. In this context restructuring support instruments are needed to encourage this kind of corporate response to preference erosion. Two possible vehicles for support exist in this context: the provision of support for technical assistance aimed at identifying new market opportunities within the value chain; and the provision of grant financing in support of investments which enable movement up the value chain. This latter intervention can either be based on a simple co-financing model, as was the case in the early interventions in the Cameroon banana sector, or on the use of grants to provide low-cost loans. The key determining consideration should be: simplicity of operation, efficiency of delivery (time-wise) and the minimisation of transaction costs and the administrative burden placed on public-sector bodies.

3.8.6 Policy response: addressing the effect on the financial sector

Where the sugar sector forms a major part of the national economy and the financial-services sector is relatively inefficient,[48] heavy income losses in the sugar sector can have serious knock-on effects, both on the financial performance of the local financial-services sector and the costs of capital to other agricultural activities (an important consideration when looking at the promotion of diversification). While by no means all ACP countries find themselves in the same situation as Swaziland, there are a number of countries where in recent years smallholder sugar-farming schemes have been set up and where financial arrangements will need to be reviewed. Equally there are also a number of countries where the sugar sector is of such importance that it is a major borrower from local financial institutions.

This situation can require the provision of funds for refinancing of loans, the writing-off of certain debts[49] or the recapitalisation of financing bodies (where these are not commercial financial institutions). Initiatives in this area can have very important stabilising effects in the sugar sector and can create conditions in which other forms of sectoral-adjustment support can be successful

Addressing financial-restructuring issues is also important since a failure to do so can lead agricultural lending in general to be high risk, with consequent increases in the costs of capital just when such capital is needed for restructuring and diversification. This drying-up of bank financing or the increase in its cost can serve to undermine the commercial viability of what would otherwise be viable diversification or restructuring activities. This is a particular problem where inefficient financial services exist. Given its long-term implications for diversification this is an area in which too little attention has so far been given in the context of the sugar sector when seeking to get to grips with the challenges of preference erosion.

3.8.7 Policy response: addressing the government-revenue effect

The case of Swaziland illustrates the impact that loss of income on sales to the EU market can have on government revenues, with the tax-take from industry-specific taxes, corporate taxes and personal income tax all being affected. These revenue losses will however be occurring at a time when the direct impact of preference erosion is leading to an increased demand for government-provided goods and

services, arising from the disengagement of the industry from the financing and management of health and education facilities, social welfare and public-utility provision in sugar-growing areas. The increased demand for retraining linked to retrenchments in response to income losses on sugar sales to the EU only serves to compound these problems. Of course problems of government financing are even greater in those ACP countries where the sugar sector is under state control.[50]

The normal EC response to this situation would be the extension of budgetary support. However in the case of Swaziland, the budgetary-support option has been explicitly ruled out due to wider policy considerations linked to the government's performance. The reality is thus that budgetary support can be and often is linked to policy conditionalities, and this can effectively prevent the use of what is the EU's fastest-disbursing aid instrument.

This issue of budgetary support and conditionalities would appear to be of considerable importance to those sugar sectors which are under state control. Experience in the banana sector however suggests that when dealing with the consequences of preference erosion the imposition of even sector-specific conditionalities requires careful consideration. For example, in cases of state control of the industry one of the conventional demands would be for privatisation. However, such a demand may be quite unreasonable, since the situation of preference erosion may be generating so much uncertainty as to future market- and production-prospects, as to make the motivation of any private-sector interest in taking over state-run enterprises, extremely difficult. This was certainly the case in the banana sector in Surinam.[51] This did not preclude however the adoption of restructuring measures, which enhanced competitiveness and production and turned around the sector's export performance, developments which may well have laid a basis for later commercialisation and even privatisation of the sector.

3.9 The experience of the EU policy response in the sugar sector – the trade dimension

3.9.1 Trade response: expanded access to the EU market

To date there has been little progress on the issue of expanded duty-free access for those low-cost ACP sugar producers who can profitably supply the EU market at the lower post-reform prices. Indeed, with the growing difficulties faced in the EU sugar sector, the EC is becoming more and more reluctant to discuss the use of expanded market access as part of the EU's policy response, with this dimension having virtually disappeared from the arena of discussion.

A complicating factor in this regard has been the slow progress of EPA negotiations. Despite EC insistence on taking existing sugar-protocol access into regional EPAs (accompanied by a "mutual renunciation" of the sugar protocol), there is no clarity on how this is to be done, in a context where in some regions:

countries enjoying unlimited access to the EU market (LDCs) sit alongside countries with quota-restricted access (non-LDC sugar-protocol beneficiaries) – the ESA configuration;

countries enjoying quota-restricted access to the EU market sit alongside countries with no preferential access for sugar exports – the Caribbean configuration;

countries enjoying unlimited access, sit alongside countries enjoying quota-restricted access and countries for whom the granting of tariff-free access is virtually inconceivable at the present time – the SADC configuration.

In this context, with only around nine months to go until the deadline for the conclusion of EPA negotiation, major decisions are being left hanging in the air. Meanwhile the sugar-sector private operators are making their own investment choices based on legally enforceable market-access arrangements, leaving aside the "definite maybe" of EU policy-making.

Looking beyond sugar, ACP countries are hoping for the unqualified extension of EBA-equivalent access to the EU market for all ACP countries.[52] Unfortunately many of the areas where the EU would have to remove residual market-access restrictions are "sensitive" within the EU and the EC is likely to seek special arrangements in these areas to protect EU production interests until the process of CAP reform is completed in these sectors. The EC is also seeking to use any further market-access concessions to secure agreements on "behind border" issues. While this may be consistent with the EC's new trade strategy, it is scarcely consistent with the 2005 statements by Trade Commissioner Mandelson on extending additional preferential access to the EU market as an integral part of the policy response to preference erosion in the sugar sector.

3.9.2 Trade response: supporting the development of regional markets

While the EC has recognised the need to nurture regional sugar markets, this has not been translated into trade-policy measures in the context of the ongoing trade negotiations. In southern Africa, where low-cost sugar production provides a basis for a competitive sugar-based value-added products industry, there is concern to avoid a temporary flooding of regional markets by EU products, while export refunds for sugar-based value-added products remain in place[53] as the process. The Swaziland Sugar Association has therefore called for the inclusion in the EPA of "provisions which nurture the development of regional demand for regionally produced sugar and sugar-containing food products"[54] and the "modification of the existing provisions of the EU-South Africa TDCA … [which] will be essential if regional demand for regionally produced sugar and sugar-containing food products is to be nurtured".

This proposal however is meeting considerable hostility from the EC and EU member states and so little attempt has so far been made to elaborate on the regional-trade-policy component of an EU sugar-sector response strategy.

3.9.3 Trade response: getting the policy framework right

The only area where the EC is actively pursing a trade element of its envisaged sugar-sector response strategy is with regard to getting the policy framework right. Across ACP EPA negotiating configurations the EC is seeking to place "behind border" issues centre stage in the negotiations, even going so far as to describe agreements in trade-related areas and trade in services as "the essence of the EPA sustainable-development package". While there can be little argument that the policy framework for responding to the challenges of preference erosion can be a critical factor in the effectiveness of any response strategy (though in the Cameroon, a range of successful measures were introduced without any discussion of the wider policy framework[55]), this needs to be an integral part of a much wider trade-policy response, designed and led from within the affected countries and regions.

3.10 The experience of the EU policy response in the sugar sector – the development-finance dimension

3.10.1 Development assistance: ensuring early delivery

From the outset it was recognised that the early deployment of restructuring assistance would be vital in supporting pro-active processes of adjustment. Trade Commissioner Mandelson emphasised the need to support ACP countries in preparing for change, rather than simply responding to it. The significance of early aid-deployment was given extra weight by the two-year deferment of substantial price reductions under the final EU reform agreement. Early aid-deployment however was critical to making the most of this breathing space. Unfortunately the overall experience of financial assistance to sugar-sector reform to date has not been good, with funds committed in 2005 only being programmed in October 2006 and actual expenditures only likely to take place in the second quarter of 2007.[56]

What is more, most of these scheduled activities relate primarily to administrative measures linked to the long-term implementation of support measures (up to 2014), with little priority being given to immediate adjustment. In a country such as Swaziland, it is estimated that as a result of EC procedures it could be 2009 before funds begin to become available for disbursement in-country in support of operational programmes. Given the experience in Swaziland since 2002 this greatly reduces the value of the assistance being made available.

In countries whose sugar industries are under state control (e.g. Guyana and Jamaica), given the EC's preference for deploying assistance in the form of budgetary support, mobilising EC aid may prove simpler. However, this will largely depend on whether an IMF-approved adjustment programme is in place, since this is generally a precondition for the deployment of general EU budgetary support. If wider policy conditionalities have not been agreed to in this context, then the provision of budgetary support for sugar-sector adjustments could prove to be equally problematical.

In those countries where sugar-sector adjustment programmes have long been in place and where an efficient public administration with experience in accessing EU funds works closely with industry players (e.g. Mauritius), EC support should prove both more efficient and effective, although delays continue to be a concern to industry players. However, as was apparent in the banana sector, where public administrations face human and institutional constraints on the mobilisation and deployment of EC aid resources, this can become a major impediment both to industry-led restructuring processes (unless specific measures for co-financing of industry programmes are set in place) and private-sector-led and public-sector-supported diversification programmes.

Where problems of aid mobilisation are faced under routine EC aid programmes, even the mobilisation of assistance to address social-adjustment needs arising from sugar-sector-adjustment processes, could prove extremely difficult and time-consuming, particularly where this involves managing a transition from industry-supported social infrastructure towards some other model for the management and financing of this existing social infrastructure.

Only if the lessons of the banana- and sugar-sector experiences to date are drawn upon and specific instruments and procedures are established to address specific challenges, based on what has proved to work in the past, is it likely that

comprehensive programmes of assistance to address the challenges of preference erosion will prove successful.

In this context the key to effectively addressing the issue of preference erosion is delivering the right mix of investments with minimum delays and low transaction costs.

3.10.2 Development assistance: ensuring close industry involvement

Where sugar sectors are largely privately owned and managed there is a need to ensure that measures to enhance competitiveness are developed in close consultation with the industry. Sector associations (where they exist) will need to play a critical role in defining priorities and managing the implementation of adjustment measures. As the experience in the Cameroon banana sector illustrates, this applies equally to the economic operators in the sector.

In the case of the Swaziland Sugar Association initial efforts to prepare for EU reforms began in November 2004 and despite profound human-resource constraints resources were mobilised to elaborate an industry-response strategy, which provided the foundations for the 2006 national adaptation strategy. However the slowness of delivery of assistance to concrete initiatives on the ground is leading this representative body to become disillusioned with the EC support to the design and management of the national response strategy. Assessments of the use of a "business as usual" approach to what are time-sensitive adjustment needs, suggests that funding will not become available for operational programmes on the ground in Swaziland until late 2008 or early 2009, coinciding with the final stages of the implementation of EU price cuts. This operational experience stands in stark contrast to Trade Commissioner Mandelson's emphasis in January 2005 on the need for the early deployment of aid to help ACP sugar sectors prepare for change, not merely respond to it. It does however closely reflect the operational experience of banana-sector support measures in the Windward Islands under the special framework of assistance.

This is compounded by a sense of marginalisation in the design and management of the response measures, arising from the EC's chosen method for managing this programme of support. Clearly a new approach to working with private-sector actors in the sugar industry, which moves away from conventional EC aid-deployment procedures, is needed if effective assistance in enhancing the price competitiveness of industry and addressing the social-adjustment costs associated with the implementation of EU sugar-sector reforms is to be deployed.

This constitutes one of the major lessons to date from the experience of EC sugar-sector support to ACP private-sector-based sugar industries. This however will raise important policy questions about the role of public-aid deployment to private-sector-based processes of economic restructuring, questions which may be new to the aid administrations of EU member states, but ones of which the EU in its own internal agricultural policy has extensive experience.

3.10.3 Development assistance: building on what exists

An important lesson from the Swazi case study is the importance of building on what already exists. This applies both organisationally and operationally. If representative industry-wide bodies already exist, then management structures to implement support measures for sugar-sector adjustment should not be set up independently of these representative structures, but should have a close working relationship which builds

on existing forums for dialogue within the industry. Where such bodies do not exist, supporting their creation may represent an important first step in ensuring an inclusive approach to the design and management of sugar-sector-adjustment programmes.

If administrative capacity exists in the industry at the corporate level to manage the deployment of financial assistance, then assuming that transparency and accountability can be ensured, these structures should be utilised in deployment of assistance to operational programmes (for example, this applies as much to financial institutions engaged with the sugar sector and corporate programmes of extension work as it does to the management of health-and-education facilities in sugar-growing areas). Establishing basic ground rules for what is and what is not permitted is essential.

This principle of building on what exists applies equally to operational programmes, particularly in a context where industry players are normally ahead of public-sector bodies (including external funding agencies) in responding to the adjustment challenges arising as a consequence of preference erosion. Here again important policy issues will arise that should be addressed at the outset, within the process of programme design.

4. Developing a comprehensive response to preference erosion

4.1 Types of measures required

4.1.1 Overview of areas of response

In formulating a response to the process of preference erosion that is underway in ACP-EU trade, seven concrete areas for action can be identified. Three of these are primarily trade measures or trade-related measures, three of them are targeted "aid for trade" measures in support of the trade adjustments that will be required as a result of preference erosion, while one can be considered a cross-cutting issue.

Specifically on the trade and trade-related side the kind of measures required include:

- the early removal of all remaining tariff and quota restrictions on ACP food-and-agricultural exports to the EU, so that full advantage can be taken of what margins of preference remain for as long as they remain;
- cooperation on administrative arrangements to reduce transaction costs on exports to Europe, particularly for small ACP suppliers and countries undertaking diversification;
- the establishment of clear time-bound procedures for the resolution of SPS disputes, including the establishment of arbitration arrangements in case of non-resolution of the SPS dispute within the agreed time-frame.

On the development assistance/"aid for trade" side the specific kind of measures required include:

- the establishment of "aid for trade" packages to assist in production adjustments to enhance efficiency and reduce costs, to meet "quality" standards and facilitate movement up the value chain and provide targeted support to improve marketing;

- the establishment of aid instruments to support diversification out of the affected sectors (involving the provision of both technical and financial support) both within agriculture and beyond;
- the provision of support to social adjustments in affected sectors and communities to reduce the transition costs and support the maintenance of an investment-friendly environment.

The major cross-cutting issue, which is highly politically sensitive, relates to:

- the provision of support to public-sector management, institutional reform and policy reform.

In each of these areas detailed measures and appropriate modalities for their implementation, on a sector-, country- and region-specific basis, will need to be worked out.

Let us review each of these areas in turn, first with regard to the types of measures required and second with regard to operational modalities for implementation. This latter area is critical to the effectiveness of support in addressing the challenges arising from preference erosion, given the time-sensitive nature of the adjustment processes involved.

4.1.2 The market-access response

EU Trade Commissioner Mandelson on a visit to the Caribbean in January 2005 spoke extensively of the importance of improving market access to compensate for price declines. He stressed that "although we are entering a period of change and reform we are not going to create an open, liberalised market on sugar in Europe. Tariff protection will continue and the preferences that we have traditionally extended to … ACP countries will also continue". Increased volumes and additional market access "would have a neutral impact"[57] on ACP sugar industries. He clearly indicated that such preferential access would be provided through the economic partnership agreements which were under negotiation. This recognition of the scope for fully exploiting the remaining margins of tariff-preference is now however being played down by EC officials in the light of the difficulties faced in implementing the EU's "voluntary" restructuring scheme.[58] This is unfortunate since there is considerable scope for growth in the sub-set of ACP exports where residual market-access restrictions exist. Removal of these residual market-access restrictions would act as a major incentive to investment in these sectors in a number of ACP countries.

Evidence for this is provided by the investment response in southern and eastern African LDCs to the granting of EBA trade preferences. Production is rapidly expanding and by the date of the removal of EBA quantitative restrictions on LDC sugar exports, production in Malawi, Mozambique, Tanzania and Zambia will have expanded by 600,000 tonnes (in a context of current exports to the EU from these countries of slightly over 100,000 tonnes). Similar although less dramatic investment trends are apparent in the fruit-and-vegetable sector. Thus the removal of these residual market-access restrictions in those ACP countries not set to enjoy full duty-free and quota-free access (many of which are facing significant processes of preference erosion) could provide an important stimulus to investment in new production capacity.

However, it needs to be borne in mind that the ongoing process of CAP reform and the EU's resurgent interest in concluding free-trade agreements with advanced

developing countries is likely to rapidly erode the additional value obtainable through preferential exports to the EU market. This means that if the policy tool of improved market access is to be used to respond to preference erosion in the sugar and banana sectors, then it will be necessary to eliminate the remaining EU market-access restrictions immediately.[59] Any deferment of EBA-equivalent access would greatly reduce the utility of such market access (particularly in attracting new investment), since by 2015 to 2020 it seems likely that in large part the additional value to be had in supplying the EU market under preferential market-access conditions will have disappeared.

Of course residual market-access restrictions represent only one dimension of the required trade response. The other dimensions relate to non-tariff obstacles to trade.

4.1.3 Reducing transaction costs

Perhaps the most important area with regard to reducing transaction costs relates to the EU's increasingly strict food-safety and SPS standards. While this is a multi-dimensional problem two brief examples will suffice to highlight the types of issues which need to be addressed and the types of steps which need to be taken as an integral part of an effective policy response to preference erosion.

Our first example relates to the inspection charges levied on imports into the EU. Increasingly the EU is basing its food safety and SPS inspections on "risk assessments". While this constitutes a logical approach it has a number of unplanned commercial implications which can come to constitute significant barriers to agricultural diversification. Since an established track record as an exporter is essential to proper risk assessment it can lead to inspection costs for newly emergent exporters 400 times more than those charged to established exporters (based on more frequent inspections – up to 20 times more frequent – and more intensive inspections carrying higher unit costs – up to 20 times more). This can come to constitute a major impediment to emergent exporters, since the prices initially received on exports are less favourable as the new exporters are still finding their way around the EU market.

In this context there would appear to be a need for

- close administrative collaboration on SPS inspections;
- the establishment of a "ceiling" on inspection charges levied on newly emergent exporters;
- the establishment of a fund to off-set the costs of inspection over the five-year period while a track record is being built up by newly emergent exporters.

Our second example relates to administrative requirements for inspections and how this can hinder movement up the value chain. The example relates to Kenyan bean exports, where efforts to create a diversified range of microwave-ready bean products, through the addition of flavoured butters (imported from the EU) fell foul of EU dairy regulations.

Such administrative anomalies can constitute significant barriers to movement up the value chain, and their existence need to be systematically reviewed and eliminated. With the movement over to a single EU regime,[60] (rather than commodity-specific regimes) this should not prove difficult. However, it will require a conscious effort if

such administrative obstacles are to be removed from ACP countries seeking to diversify out of single-commodity dependency in areas of preference erosion.

4.1.4 Establishing time-bound procedures for SPS dispute settlements

EC departments responsible for ensuring the safety of food placed on the EU market and for maintaining the sanitary conditions for plant and animal production in the EU often have a limited number of staff for deployment in dealing with an increasingly demanding set of tasks. Often resolution of SPS disputes with third parties, particularly small developing countries, is not accorded a high priority in determining human-resource deployment. Priority tends to be given to issues relating to EU exports and issues relating to trade with major trading partners (70 percent of global agricultural trade is between only nine WTO members). ACP countries commonly fall a long way down the list of priorities. As a consequence disputes can drag on for many years. Namibia's bone-in lamb dispute for example is entering its seventh year, with no prospect of resolution in sight and with the EU market effectively closed to the most commercially attractive form of lamb exports. In this context formal, time-bound dispute-resolution mechanisms are required, since this would place a legal obligation on the EC services to respond within a specified time-frame. Establishing such measures would remove an important obstacle to the development of non-traditional exports in a number of ACP countries and would reduce uncertainty over future access to the EU market.

This is of growing important since with the increasing number of EU regulations there is little or no consideration being given to the practical operational implications for developing-country suppliers, whose production systems differ from those in the EU and who certainly face very different human and institutional capacity constraints. This can create enormous uncertainty as to whether the EU market will remain open to exporters from individual ACP countries.

Establishing a clear, time-bound, procedure for the resolution of SPS disputes would go some way towards removing uncertainty, especially if combined with an arbitration mechanism in cases of non-resolution of the dispute and an intensification of dialogue on how new EU regulations are to be applied in practice in ACP countries.

4.1.5 "Aid for trade" support within the sector

What the experience in the ACP banana and sugar sectors highlights is the wide scope for possible interventions to assist with adjustment processes within sectors affected by preference erosion. The early experience of the EC-supported special programme of assistance to ACP banana producers in Cameroon and Belize highlights how productivity can be improved and costs reduced through the direct co-financing of targeted programmes of support to producers to implement productivity improvements and cost-reduction measures. If properly implemented such measures can yield significant gains in competitiveness.

Experience elsewhere (for example in Surinam) highlights the benefits that can be gained from the reorganisation of institutions involved in production support, collection and shipment. The experience in the Windward Islands highlights the difficulties faced in reaching out to assist smallholders in improving yields and reducing costs. However, the wider experience in the Windward Islands with the development of "fair trade" bananas highlights the importance of developing increasingly sophisticated marketing strategies designed to serve the "luxury

purchase" component of the EU market. This also of course requires production innovation and considerable administrative support to demonstrate compliance with the quality/ethical standards set.

The extent to which development of marketing strategies to serve the "luxury purchase" market component can transform the prospects of an industry which previously had looked doomed, suggests that dedicated instruments should be created to deploy, in an integrated manner, the support required to enable ACP suppliers to serve these components of the EU market. This is particularly the case because compared to directly production-related, cost-saving and productivity-focussed programmes, other systems of aid delivery may be required in this area.

Similar issues arise with reference to the extension of support to movement up the value chain, as an integral part of the sectoral response to preference erosion. The reality is that often those countries with the greatest need of moving up the value chain are not "natural" investment locations for private-sector investments in value-addition activities. In these cases specific financing instruments need to be created to encourage private-sector investment in value-added processing activities. This could take the form of a grant-financed investment subsidy (a common enough practice under the EU's internal rural-development programmes) or the provision of low-interest loans for investment in specified value-addition activities. In certain circumstances scope could exist for deploying budgetary support for the creation of tax breaks when companies invest in value-addition activities.

What would appear to be appropriate from the experience to date in the banana and sugar sectors is the need for:

- clearly defined "aid for trade" programmes targeted at achieving specific sectoral objectives (reduction of production costs, productivity improvements, better organisation of transport and shipping, improve marketing, support for value addition);
- the establishment of appropriate instruments of support (grant-based co-financing, grant-based concessional loans, support for technical assistance, support for investment) for the implementation of the programmes of measures;
- the identification of appropriate channels for aid delivery with a view to the delivery of assistance swiftly and at minimum cost.

4.1.6 Supporting diversification

A number of distinct aspects of the diversification challenge can be identified, which require both public-sector and private-sector oriented support measures. Beginning with diversification within the agricultural sector geared towards exporting to the EU, one of the most important areas for public-sector initiative is in regard to the establishment of an effective food-safety compliance and verification capacity.

With the increased responsibility placed on public authorities in third countries to ensure compliance with EU food-safety standards under the EU's food-and-feed control regulation, ACP governments face major new institutional challenges in ensuring that the EU market remains open to national food and agricultural exports. A CTA-financed study estimated that first-phase assistance needs in establishing the policy, regulatory and basic institutional infrastructure for ensuring food-safety compliance amounted to €187 million across all ACP countries. If this capacity is not

in place then it makes it very difficult to attract investment in agricultural diversification.

This thus constitutes the first-level challenge in attracting private-sector investment in agricultural diversification for production oriented towards the EU market. This is an obvious area for "aid for trade" support. While the EU has recognised this need, insufficient funding has been deployed up to now to meet the challenge.

The second area for public-sector intervention in promoting investment in agricultural diversification is the creation of an investment-friendly environment. In this area a multiplicity of policy changes may be required, with the situation varying greatly from country to country in the ACP. However, the process of preference erosion in and of itself, along with the trade response of the EU can seriously influence the scope for policy change. This is illustrated by the experience of the banana sector in Surinam, where reportedly, the uncertainty over the evolution of the EU trade regime for bananas has made it extremely difficult to motivate private-sector investment, despite a government commitment to privatisation since 2003.

This suggests a need for a careful and "joined up" approach to policy change, that seeks to address the challenges of preference erosion as an integrated whole.

Turning to the role of the private sector in agricultural diversification, two distinct areas of support needs can be identified:

- the need for support for technical assistance in identifying new market opportunities;
- the need for financial assistance to investment in diversification activities.

Any agricultural diversification has to be based on a careful identification of market opportunities – be they national, regional or international. Often ACP farming enterprises (particularly smallholders and medium-sized farms) lack the experience and expertise to address the marketing challenges faced. Targeted instruments of support are required to assist small- and medium-sized producers in meeting this challenge. Cost-sharing grant schemes can offer a simple vehicle for the delivery of such support.

Box 4.1 *Cost-sharing grant schemes*

Cost-sharing grant schemes provide grants to enterprises to use a wide range of business-support services in order to help them to adjust to changing markets and competitiveness challenges. The grant element of the schemes varies from scheme to scheme, but generally the range is between 40 percent and 70 percent of the total cost of the agreed services. The company applying to the scheme agrees with the managers of the scheme (often a local private-consultancy company acting as the programme management unit) on a programme of activities. Usually these activities form part of a broader business plan, linking activities to objectives. Often the managers of the scheme assist the applicant company in developing an appropriate programme of activities.

Services are then contracted in by the applicant company which pays up-front. Only after the activity has been completed, does the company apply for and receive the grant for the agreed activities, on the basis of receipts and proof that the activity has actually taken place. The key to the scheme working effectively is the swift

processing of applications for grants, with payments taking place no longer than two weeks after submission of all the appropriate supporting documentation.

Cost-sharing grant schemes have four main advantages: they provide resources direct to the applicant companies; they introduce companies to business development services; they ensure that only genuinely beneficial activities are initiated by requiring an own contribution; they serve to consolidate the capacity of local business service providers.

As the experience in Swaziland demonstrates, the wider financial repercussions of preference erosion can result in a sharp increase in the cost of borrowing for agricultural enterprises, precisely at a time when low-cost financing is required in order to encourage a dynamic response to preference erosion. In this context the provision of "aid for trade" support to establish low-cost loan facilities to support agricultural diversification would appear to be essential (an alternative to subsidised loans is grant co-financing).

Outside of the agricultural sector similar public- and private-sector initiatives may be required, although in many instances where trade in goods is concerned similar instruments could be used. Specific additional issues would only appear to arise where diversification strategies focus on the development of trade in services. Given the wide scope of issues faced in developing trade in services as a diversification option in the widely varying circumstances of ACP countries, careful consideration will need to be given to what type of support instruments would be appropriate. However, it should be noted that the EC itself, in the context of its rural-development policy is gaining considerable experience in supporting the development of rural-based service sectors. An early priority would thus appear to be the initiation of a systematic review of the EU experience in this area, to see to what extent lessons can be learned of relevance to supporting diversification into various service sectors in ACP countries faced with preference erosion. Realism, based on the constraints faced in ACP countries, will however be required in undertaking such an assessment.

4.1.7 Meeting social-adjustment needs

The social-adjustment challenge arising from preference erosion is not simply a social issue. It has important political and economic consequences. If social-adjustment needs are not addressed, the social dislocation that occurs can carry very real political and economic consequences which can undermine other dimensions of the policy response to preference erosion. The political dimension is not simply an electoral problem.[61] A failure to address the social dimension of preference erosion can lead to political instability that then discourages foreign investment.

Futhermore, declines in education and health provision and reduced purchasing power in affected communities can carry real economic consequences that constrain investment and diversification opportunities.

It is therefore essential that instruments of support be established which address the social-adjustment needs arising as a consequence of preference erosion. The most obvious instrument of support in this context is targeted budgetary support, to enable governments to address health and education needs and launch labour-intensive public works in affected communities to counter the deflationary impact of preference erosion in the local economy.[62]

Working out precisely how non-state actors can engage simply with the delivery of assistance linked to meeting the challenges of preference erosion is particularly relevant in transitional situations, for example, where a transition is underway from industry-managed-and-financed provision of various services towards some alternative model for the sustainable management and financing of these services. The experience of Swaziland clearly demonstrates the need for such transitional programmes in the areas of the managing and financing of health, education, social welfare and public utilities and the difficulties faced in establishing appropriate support mechanisms. It clearly demonstrates that innovative approaches are needed in comprehensively addressing these problems, approaches which in turn may require a review of aid-deployment procedures and regulations.

The important point is for there to be a systematic approach to addressing the social impact of preference erosion, including support to retraining and employment creation through micro- and small-enterprise development. While some progress has been made conceptually within individual country programmes supported by the EC, there is no evidence that this is yet leading towards the creation of a systematic approach to addressing the social impact of preference erosion.

There would appear to be a need to review the experience of what has worked to date in the banana sector along with the ideas being put forward in the context of the policy response to EU sugar-sector reforms, in order to clearly identify needs and what has worked in the past in addressing the different dimensions of the social impact of preference erosion. This would create a platform for the identification of appropriate instruments of support for addressing this dimension of the challenge of preference erosion.

4.1.8 Supporting public management and institutional and policy reform

In many respects this is the area where international donors have the greatest experience of extending assistance (under structural-adjustment programmes and beyond). Indeed this area is increasingly being stressed through the emphasis on getting the "policy framework right", within inter-regional trade agreements. However, this is not simply a question of making the right policy choices; it is also about the practical operational application of these policy choices in the context of the realities faced in the country concerned. It is not simply a question of "where you want to go", but "how you can actually get there". This is well illustrated by Surinam's experience in the banana sector.

Efforts have been under way in Surinam to privatise ownership of the banana sector since the collapse of the state-marketing company in July 2002. However, the uncertain market prospects linked to ongoing changes in the EU banana regime have made it difficult to follow through on the commitment to privatisation of the sector. This lack of progress however has not held back the rehabilitation of the sector, with the second largest ever volume of exports to the EU market being attained in 2005 (35,000 tonnes compared to 39,000 tonnes in 1999 and a low of 7,000 tonnes in 2002).

Clearly while institutional and policy reform is important, it is not the whole picture when it comes to responding to the challenges of preference erosion. This is further illustrated by early experience in the Cameroon banana sector, where the wider policy context was largely ignored and the focus was on field-level productivity

improvements, a focus which over the period supported a large-scale expansion of Cameroonian banana exports to the EU.

This is not to denigrate the importance of policy and institutional reform; indeed these considerations will take on greater and greater significance as the process of preference erosion accelerates. However, it does suggest that support for policy and institutional reform and improvements in public-sector management should form an integral part of a comprehensive response to preference erosion, with the emphasis being on the integral nature of the whole package. This is not to imply the application of crude conditionalities, but rather a recognition that policy and institutional reform and enhancement of public-sector management capacities form an integral part of an effective policy response to preference erosion.

4.2 Operational modalities for implementation: a menu of options

4.2.1 Increasing productivity and reducing costs

Experience suggests that measures to increase productivity and reduce costs are most effective where they are designed and implemented by the economic operators concerned. Given the impact which the process of preference erosion can have on the cost of financing for agriculture-related activities, particularly in the sector concerned, the need for financial assistance in this area is very real. Based on past experience this support can best take the form of:

- grant co-financing of measures to improve productivity and reduce costs, with operational measures being implemented by the economic operators concerned and a specific percentage of the agreed costs being speedily reimbursed against submission of receipts and supporting documentation;
- a grant-financed subsidised loan facility, administered as appropriate by local financial intermediaries or industry associations;
- swap arrangements for a restructuring fund involving budgetary support for tax breaks, under which budgetary support is extended equivalent to an industry-specific tax break, linked to the payment of a restructuring levy paid into a fund for the financing of private-sector based restructuring and diversification initiatives - the major benefit of this approach is to free private-sector operators from cumbersome aid procedures which can delay and undermine restructuring measures.

Key considerations in determining the appropriate modalities would be the institutional management capacity available locally, the transparency and accountability of management procedures and the costs of aid delivery.

Box 4.2 *Linking the policy response to the local reality*

Different sources of preference erosion affect different countries differently, depending on their underlying costs of production. Different effects, of course, require different responses. However equally the ability to effectively absorb assistance is influenced not only by the underlying cost structure but also the mode of organisation of production. These local realities need to be taken into account in the design of assistance instruments, for what works in support of production adjustment to estate-based systems is quite different from what works with smallholder-based production

systems. Equally, different patterns of ownership and state involvement form an integral part of the local reality which needs to be taken into account in the design and implementation of support measures.

4.2.2 Institutional and management reforms

While institutional and managerial reform can be a critical factor in re-invigorating economic prospects in sectors affected by preference erosion, through its impact on lowering costs, improving production and facilitating marketing, this is often a complex and long-term process. This is particularly the case where the process of preference erosion leads to market uncertainties. Extending effective support in this area would appear to require a dedicated instrument and management unit to try to ensure cross-fertilisation of experiences across affected countries.

However, such support needs to be provided within a long-term perspective. The key to extending support in this area is flexible yet strong management which takes into account local institutional realities and management constraints and seeks to build and strengthen local capacities.

Box 4.3 ***Achieving a consensus on the local realities***

The importance of identifying the underlying local realities which need to be taken into account in designing the policy response is widely recognised. However securing a consensus on the nature of these underlying local realities is not always a simple task and indeed, can be politically fraught. Exercises undertaken at the start of multi-annual programming processes are commonly only formal exercises, with substantial revisions subsequently being required. This reality must be taken into account in the design of policy responses and policy instruments, with the dynamic of the market being allowed to drive the debate over time. This means that policy responses to preference erosion have to be flexible enough to allow changes to be made in the approach in the light of the underlying realities.

4.2.3 Improving marketing: making the transition to serving "luxury purchase" markets

The major trend in markets that are subject to preference erosion is the emergence of the "luxury purchase" component of the market, where despite overall demographic trends there is strong growth and favourable price trends.[63] For ACP countries currently facing the erosion of the value of traditional trade preferences one of the important policy responses is to increasingly promote production to serve these "luxury purchase", quality-conscious components of the EU market.

However support will be needed in making this transition, both in identifying emergent trends in key sectors and in adjusting production to serve these markets. There are two distinct ways to go about supporting this process:

- to support the elaboration and implementation of sector-specific programmes to target "luxury purchase" components of the market (including support to both market identification and production adjustment);
- to create a facility for the co-financing of individual activities related to developing markets for "luxury purchase" products and making the necessary production adjustments.

While the design and implementation of sector-specific programmes offers a comprehensive approach, the lengthy gestation period for such programmes under existing aid procedures (from four to twelve years in the case of EC-financed programmes) may not provide the flexibility required in responding to the dynamic evolution of markets. Given the need for speedy and timely delivery of support, the creation of a co-financing facility for individual activities may provide a more promising option, particularly where the model of the cost-sharing grant scheme can be used.

4.2.4 Supporting movement up the value chain

Similar considerations arise with regard to supporting movement up the value chain. Here a combination of support for a cost-sharing grant scheme, designed to identify markets and test their viability, and subsidised loans for capital investments in value-added activities would appear to be appropriate, with a preference for support for investment in the commercial development of new product lines being the provision of low-cost loans.

4.2.5 Diversification in agriculture: infrastructure for public food-safety compliance

A critical consideration for agricultural diversification for overseas markets will be the establishment of effective verification capacity for food-safety compliance at the national level. The challenges faced in this area should not be underestimated, although equally the capacity that already exists in ACP countries should not be denigrated. Support for a comprehensive rolling programme of action in support of the development of national capacity will need to be set in place. This could well be made available through the extension of existing international initiatives or existing bilateral programmes, depending on what is working in a specific national context. However a special emphasis should be placed on extending support to countries facing the challenge of preference erosion, since the commercial underpinnings for the ongoing financing of such facilities are likely to be far from proven.

Grant financing should be made available for:

- baseline work on the policy, legislative and institutional needs;
- the establishment of necessary institutional infrastructure;
- the training of staff;
- support for the development of appropriate models for the financing of food-safety infrastructure to ensure financial sustainability in the medium to long term;
- special initiatives to ensure that small-scale producers can continue to participate in the sector.

Low-cost loan financing should be made available to private-sector bodies to make investments to meet food-safety standards, with possible links being made to the payment of industry levies to finance the operation of food-safety infrastructure.

It should be noted that while currently food-safety standards are primarily an issue in overseas trade, as certain countries seek mutual recognition and equivalency agreements with the EU on food-safety issues, food-safety standards will increasingly become an issue in intra-regional trade as well.

Box 4.4 *Getting the right mix of support measures*

The lack of consensus on underlying realities can make it very difficult to determine the most appropriate policy mix required. Yet the key to effectively addressing the issue of preference erosion is delivering the right mix of investments with minimum delays and low transaction costs. How then do you identify the right mix of investments in any given reality? Clearly objectives need to be clarified. But should this be built into the design of the instruments of support to address the challenges of preference erosion (with different windows for pursuit of different objectives and access being based on calls for proposals) or should it be left to each affected country to determine the appropriate mix, and if so, who in each country, the government or the industry? These are the kinds of basic questions that will need to be resolved in designing policy instruments for responding to preference erosion.

4.2.6 Diversification in agriculture: supporting private-sector investment

In terms of support to private-sector investment in agricultural diversification, here again it is necessary that this be private-sector designed and implemented and that it be market-led. In this context this support can best take the form of:

- grant co-financing for initial market identification and development activities;
- grant-financed (so as to avoid exchange-rate risks) low-cost loan schemes for investment in production.

The role of the state in private-sector-based production systems should be limited to the mobilisation of support for such facilities and the monitoring of their management and utilisation.

Clearly where production in sectors affected by preference erosion is under state control, while budgetary support offers the simplest method of aid delivery, it is not always the most efficient in terms of production-adjustment outcomes. Specific models for aid management for agricultural diversification in state-controlled sectors may well need to be developed, so as to ensure efficiency in the outcomes achieved, as well as to capitalise on the relative administrative simplicity and speed of provision of budgetary support.

4.2.7 Diversification in agriculture: supporting a market-led approach

Diversification in agriculture has to be market-led. Understanding the evolution of global food markets is very important in this context. This is particularly the case for those ACP countries facing preference erosion, which as a result of their geographical location and physical characteristics (e.g. small-island or land-locked countries), face intrinsically higher costs of production than agricultural suppliers from large competitive developing countries. For many of these ACP countries competing on costs is not a viable option and they will need to compete increasingly on quality not price. This is one of the major lessons from the banana and rum experiences in the Caribbean.

In this context, access to information on developments in “luxury purchase” components of overseas markets becomes critical, as does the development of a capacity to effectively exploit such market intelligence. This will require:

- the establishment of support programmes for the provision of market information;
- the establishment of support instruments to facilitate the exploitation of this market intelligence (perhaps using the model of the cost-sharing grant scheme).

However, the closer the activities get to commercial exploitation of opportunities the lower should be the grant component. Already throughout the ACP a multiplicity of measures in this area are under implementation. It makes sense to build on such initiatives on a country- and region-specific basis, where such initiatives have a proven track record.

Box 4.5 *The timeliness of the response and aid delivery*

Given the evolution of the processes of preference erosion and the rapidly changing market context, the timeliness of the policy response is critical. This applies to both the trade response and the aid response. For aid delivery this throws up the vital question of how to deliver appropriate support in a timely, efficient and effective manner.

This is a particular problem for smallholder-based production systems where there is often a lack of organisational capacity to effectively engage with external funding agencies. This throws up serious organisational development challenges, challenges which simply cannot be circumvented by falling back on public administrations as the vehicle for the design and delivery of appropriate aid packages. Appropriate solutions will need to be found as an integral part of the policy response to preference erosion if the adverse social consequences of preference erosion are to be minimised.

At the broader level of social adjustment and wider economic adjustments policy dialogue considerations can often take precedence over considerations relating to the timeliness and efficiency of aid delivery. It would appear to be important to resolve these policy-related issues at the inception of the programme, rather than in the course of implementation. This is the case since the utility of support in addressing the consequences of preference erosion is directly linked to the speed with which assistance can be extended to making what are time-sensitive adjustments.

4.2.8 Diversification into other productive sectors

Support to diversification into other productive sectors outside of agriculture will need to be carefully defined in relation to key policy objectives, for example, employment creation or countering the local deflationary effects of preference erosion. In this area establishing a low-cost loan facility with strict eligibility criteria linked to wider policy objectives may well be the most appropriate tool.

Alternatively the provision of budget support to allow the granting of tax breaks for diversification into new economic activities could well be cost-effective in certain circumstances.

4.2.9 Diversification into services

Many of the considerations linked to diversification into other productive activities (establishing low cost loan facilities or the use of budget support to allow tax breaks to be granted) also apply with regard to diversification into services. However the

wider national policy framework is likely to have an important bearing on the effectiveness of efforts to mobilise private-sector investment in service-sector development. In this context a case can be made for:

- the establishment of a grant-based instrument of support for the analysis of wider policy considerations impacting on service-sector development.

Box 4.6 Basic questions on aid delivery

In terms of aid delivery, at a policy level a number of basic choices will need to be made.

- Should the various models for aid delivery be built into the design of the instruments intended to address the various challenges arising as a consequence of preference erosion?
- Should the models for aid delivery to be used be left to the discretion of the recipient authority and stakeholder organisations at the national level?
- Should there be some combination of the two, with broad guidelines and national/stakeholder discretion?
- What types of support should be permissible when being deployed in support of private-sector led processes of adjustment to the consequences of preference erosion?
- What aid-delivery procedures are most appropriate for deploying support through public authorities in addressing specific aspects of the challenge of preference erosion?
- What aid-delivery procedures are most appropriate for deploying support to private-sector led responses to the challenges of preference erosion?
- What types of aid are most appropriate for addressing the different aspects of the impact of preference erosion (competitiveness challenge within the sector; economic impacts beyond the sector; marketing challenges; social-adjustment challenges; policy and institutional-reform challenges)?
- What types of aid-delivery procedures are most appropriate for addressing the different aspects of the impact of preference erosion?

4.2.10 Supporting social adjustment

The importance of addressing the social-adjustment needs as an integral part of the policy response to preference erosion should not be underestimated. However, given that the social impact will vary from country to country the types of adjustment measures will also need to vary. Nevertheless, a number of types of support measures can be identified:

- the provision of targeted budgetary support in key areas of impact (e.g. education and health provision), where the state is required to take over new responsibilities;
- the provision of decentralised budgetary support to local authorities taking over formerly industry-provided public-utility provision;
- the provision of transitional support to manage the transition from current arrangements for social, educational, health and public-utility provision to a new financially and institutionally viable alternative set of arrangements;

- the establishment of social safety-nets;
- financing of public works to address the local deflationary effects;
- provision of retraining grants for retrenched workers to enhance labour mobility;
- the establishment/expansion of small-loan facilities for the promotion of small- and micro-enterprise development;
- the establishment or expansion of support services for small- and medium-business development.

Given the multiplicity of needs that may arise, the establishment of a centrally controlled social-adjustment fund may be appropriate, if the necessary managerial capacity exists locally.

However, it needs to be borne in mind that the effectiveness of such a centrally managed fund will depend on the efficiency of the administration set in place. Experience suggests that where the scale of the impact of preference erosion is large, the scale of needs and resources mobilised to address these needs can overwhelm public administrations. This limitation needs to be borne in mind and suggests a need to identify existing non-state structures active in the specific areas of adjustment impact which could play a direct role in service delivery, thereby freeing up government capacity for the management of the flow of external resources.

This more diffused approach, while lacking in overall coherence may prove a more efficient and cost-effective instrument for the delivery of assistance in the short term, when the social-adjustment needs are at their highest. Certainly the speed of delivery of support is a critical consideration in addressing social-adjustment needs, since these costs are invariably front-loaded, as the affected industry itself takes urgent measures to deal with the consequences of preference erosion.

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ENDNOTES

[1] It should be noted that in the case of bananas the initial impetus towards preference erosion was the completion of the single internal market in the EU (at the end of 1992) which required a modification to the traditional arrangements for the management of the EU banana market which had provided the basis for ACP banana-sector preferences. These administrative modifications in the context of the Uruguay Round agreement subsequently gave rise to a WTO challenge which was ultimately resolved through the dispute-settlement mechanism. This created a new dynamic which largely drove the process of modification of traditional ACP trade preferences, reversing the normal line of causality between CAP reform and multilateral processes.

[2] Sugar-sector reform was deferred from as early as 1993 to 2005, rice-sector reform was deferred from 2000 to 2004, while proposals for banana-sector reform have only been tabled in 2006.

[3] This being said the prospect of EBA access was successfully used to force EU member states to 'bite the bullet' of reform.

[4] See the speech by Commissioner Fischler in Japan, 25 July 2002:
http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=SPEECH/02/356|0|RAPID&lg=EN&display=

[5] According to the EC's December 2006 *Scenar 2020 – Scenario study on agriculture and the rural world* this situation could prove highly fluid, with new second-generation bio-fuel technologies moving towards the use of undifferentiated biomass, to produce liquid fuels. This would greatly reduce the commercial opportunities for agricultural producers arising from bio-fuel development. See the full text of the study at:
http://ec.europa.eu/agriculture/agrista/2006/scenar2020/final_report/scenar2020final.pdf

[6] Equally if EU policy is seeking to promote 'quality' not quantity of production, then securing international recognition of quality standards and labels (including various geographical indicators and geographical designations of origin) becomes an essential part of expanding the market globally for EU-produced quality products. It is not surprising therefore that this is a growing focus of EU policy emphasis in bilateral and multilateral negotiations. This in turn of course determines the market context within which preference erosion is taking place in various sectors and sets parameters to appropriate policy responses.

[7] Speech in Berlin by Trade Commissioner Peter Mandelson (SPEECH/06/507-18/09/2006)
http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/06/507&format=HTML&aged=0&language=EN&guiLanguage=en

[8] Dominica, Grenada, St Lucia, St Vincent & the Grenadines and Jamaica.

[9] Ironically this is precisely the policy objective which both the old form of CAP support and the new form of CAP support seek to achieve within the EU.

[10] The preceding period refers to the period from 1996 to 2000.

[11] See the press article on Sainsbury's decision to supply only 100% "fair trade" bananas: http://www.foodanddrinkeurope.com/news/ng.asp?n=72800-sainsbury-s-fairtrade-bananas;
and the press release from the Fairtrade Foundation: http://www.fairtrade.org.uk/ps121206.htm

[12] See 'African producers oppose the re-opening of the banana war by Ecuador and Colombia', press release OCAB/ASSOBACAM at http://www.freshplaza.com/2006/04dec/1-1_ec_ocab-bananawar.htm

[13] According to press reports already 50% of the Dominican Republic's exports are organic bananas which represent a another "luxury purchase" component of the banana market.
[14] CTA: *Banana executive brief* at http://agritrade.cta.int/en/content/view/full/2505
[15] See EC press release (IP/06/1219-20/09/2006) at:
http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/1219&format=HTML&aged=0&language=EN&guiLanguage=en . Announcing the proposal the Agriculture Commissioner Mariann Fischer Boel described the existing regime with its compensatory aid payments to growers as "a relic from the past" under which "producers are artificially isolated from the market by payments which automatically compensate them for price changes". See the speech by Commissioner Fischer Boel (SPEECH/06/517-20/09/2006) at:
http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/06/517&format=HTML&aged=0&language=EN&guiLanguage=en

[16] See EU Council report (2763 Council Meeting, 21-22 November, 2006)
http://www.consilium.europa.eu/ueDocs/newsWord/en/agricult/91815.doc
[17] This safety margin represents a financial allocation of €93.33 million. With EU banana production at 758,000 tonnes, this implies a safety margin of €123 per tonne. This gives some indication of the price declines expected on EU markets following the implementation of EU banana-sector reforms and associated modifications to the import regime.
[18] However, in November 2006 a new comprehensive plan to reform the Cameroon banana sector was announced; see the report at: http://www.freshplaza.com/2006/14nov/1-2_cm_reforms.htm
[19] See "Country report on assistance to the Cameroon: evaluation of EU assistance to ACP banana producers", Eva – EU Associations, February 2000.
[20] However this is not a criticism of the study, since these market developments post-dated the completion of the study. It is merely to illustrate how rapidly the situation can evolve.
[21] See "Country report on assistance to the Cameroon: evaluation of EU assistance to ACP banana producers", Eva – EU Associations, February 2000.
[22] It should be borne in mind that what EU member-state aid administrators may be distinctly uncomfortable with – the deployment of grant-financed aid in support of private-sector-based adjustments in response to changes in the trade regime – is something which the EU routinely provides in its own agriculture and food-processing sector, through its rural-development expenditures. Some €77 billion has been allocated for the period from 2007 to 2013 for the financing of rural-development programmes with, in some countries, up to 40% of the national programme being allocated to supporting competitiveness-enhancing measures.
[23] A situation that is common to many commodity-dependent ACP countries.
[24] In some Windward Island countries, no expenditures were made on SFA annual programmes for 2001, 2002, 2003 and 2004 by December 2004. Even in the best-performing countries no expenditures had been made by this date on annual programmes for 2002, 2003 and 2004.
[25] See "Evaluation of EU assistance to ACP banana producers", Eva – EU Associations, February 2000.
[26] See *Times of Zambia* report at:
http://www.times.co.zm/news/viewnews.cgi?category=12&id=1162878700
[27] See Reuters report reproduced in the *Hindustani Times* at:
http://www.hindustantimes.com/news/181_1720641,00020013.htm
[28] Press reports in November 2006 indicated that a Chinese firm was to build a third sugar factory in Mali at a cost of US$148 million with a capacity to produce 100,000 tonnes of sugar per annum. See report at:
http://allafrica.com/stories/printable/200611280909.html
[29] Production in LDCs such as Mozambique, Tanzania, Ethiopia and Sudan, with their large internal markets, makes production expansion a safe bet, since if the additional value on the EU market eventually disappears, production can always be sold on the domestic market.
[30] The purchase of a majority shareholding in Illovo by Associated British Foods the owners of British Sugar) would reinforce this trend, with ABF offering an alternative channel into the EU market for refined and speciality sugars exported under the EBA from Zambia, Malawi, Mozambique and even Tanzania.
[31] For details see the March 2001 EU Court of Auditors special report on the common organisation of the market in sugar at http://www.eca.eu.int/EN/RS/2000/rs20_00en.pdf

[32] Drawn from the CTA sugar executive brief at:
http://agritrade.cta.int/en/commodities/sugar_sector/executive_brief

[33] In the first instance, however, any tariff concessions are likely to be for sugar-based products, negotiated in the context of free-trade-area negotiations (see later section).

[34] See EC press release (IP/06/1591-21/11/2006) at
http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/1591&format=HTML&aged=0&language=EN&guiLanguage=en

[35] For details of expanding EU demand for bio-fuels see the USDA *GAIN* (GAIN E36129-13/10/2006) at: http://www.fas.usda.gov/gainfiles/200610/146249328.pdf; also see the announcements linked to the launch of the new EU bio-fuels policy, the press release for which can be found at:
http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/135&format=HTML&aged=0&language=EN&guiLanguage=en , while the background memorandum can be found at:
http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/06/65&format=HTML&aged=0&language=EN&guiLanguage=en . For a cautionary note on the limitations of bio-fuel development for the EU sugar sector see Scenar 2020 at:
http://ec.europa.eu/agriculture/agrista/2006/scenar2020/final_report/scenar2020final.pdf .

[36] Recent press reports have indicated that Czech sugar farmers are planning to challenge the right of foreign-owned companies to 'sell' 22.53% of the country's annual sugar quota back to the EC in exchange for restructuring aid. Their case is based on the fact that the restructuring scheme is meant to reduce production in the least agronomically favoured regions for sugar production, while the areas of the Czech Republic where quotas are being given up are "the most fertile areas for sugar production in Europe". The Czech ministry of agriculture is supporting this challenge in an effort "to negotiate with the EC for better sugar-beet producer conditions".

[37] The Scenar 2020 study estimates that the land-use implications of this target will require slightly less than half of the bio-fuel to be externally sourced. By 2020 however, it suggests that second-generation bio-fuel technologies will have developed the possibility of using undifferentiated biomass as a feedstuff to such an extent that this will begin to constrain export opportunities for overseas suppliers of ethanol.

[38] This effectively constitutes a commitment to a carefully managed approach to the development of domestic bio-fuel supplies, including a carefully regulated trade regime designed to maximise domestic EU production while promoting a sustainable development of demand.

[39] Speech by Trade Commissioner Mandelson in Berlin (SPEECH/06/507-18/09/2006)
http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/06/507&format=HTML&aged=0&language=EN&guiLanguage=en

[40] This was certainly not the case with regard to the financing of smallholder sugar-farm development in Swaziland, where dramatic price declines arising as a consequence of the devaluation of the euro against the rand, saw newly established smallholder farmers incapable of servicing their loans and facing escalating levels of indebtedness.

[41] The "right policy framework" as perceived by the EC is a broad commitment to trade liberalisation, deregulation, the establishment of international commitments in trade-related areas, liberalisation of trade in services, establishment of good governance and the rule of law. The precise scope of what is meant has of course evolved over time, with the clearest articulation being in the EC's new trade strategy, which now attaches considerable importance to getting to grips with "behind border" issues; this refers to what is the "hard-wiring" of modern economies. These issues are now seen as constituting *the* development dimension of the proposed EPAs under negotiation with ACP countries.

[42] This report set out various scenarios for EU sugar-sector reform: two scenarios provided the benchmark for judging post-reform ACP competitiveness: the "fall in price" scenario (the one which actually occurred); and the "full liberalisation" scenario.

[43] The significance in Jamaica is more at the parish level, rather than a national level; however the scale of the impact at the parish level is such as to make it of significance at the national level.

[44] 37% is the level of income decline in local-currency earnings on sugar sales on the EU market from 2002 to 2005 resulting from the depreciation of the value of the euro against the rand. In this context any reference to a 36% reduction in income on sugar sales to the EU refers to the impact of currently scheduled EU sugar-sector reforms, where the full effect will be felt from 2009/10 onwards. It is this close proximity of the level of decline in local currency earnings between 2002 and 2005 with the

impact of EU price reductions that allows us to use the Swazi experience as an approximation of the impact of the planned EU sugar-sector reforms

[45] Where no such revenue-sharing arrangements are in place the income losses will largely be passed on to the farmers. This tends to be particularly important for smallholder farmers, but of course it is largely irrelevant on estate-production systems where the farmer and the miller are the same entity.

[46] This only applies to non-LDC ACP sugar suppliers since ACP sugar suppliers will already enjoy unrestricted duty-free access to the EU sugar market from 2009.

[47] Of course where foreign multinationals are involved in the sector, this can be the vehicle for the procurement of such technical expertise and human capacity (as is the case in Swaziland in the sugar mills and on the sugar estates). However even here incentive programmes may need to be put in place to encourage such pro-active responses (as indeed happened in the Cameroon banana sector).

[48] Judged by the spread between the interest rate paid to depositors and the interest rate charged to borrowers.

[49] This is something which the EU has done in the past under the STABEX scheme and even under the early years of certain country programmes under the special programme for the ACP banana sector.

[50] The exception of course is those sugar sectors, the collapse of which would reduce the need for state subsidies of existing sugar-sector activities. However, the "benefits" from this are illusory since the employment and social-adjustment impacts that this gives rise to increase the demand for government-supported programmes disproportionately.

[51] In Surinam despite a commitment to privatisation since 2002, the uncertainty over the future of the EU banana regime and the impact of the shift over to a 'tariff-only' system has ensured that there has been little private-sector interest in taking over the operations.

[52] Except for South Africa, which is not part of the Cotonou Trade arrangement, although it is part of the ACP.

[53] Exports refunds on value-added food products have the highest rate of utilisation of any such instruments in the EU, some 99.7% over the 2002-03 period. See "Agriculture and development in the EPA negotiations" Jordbruks Verket, Rapport 2006: 32E, at:
http://www.sjv.se/webdav/files/SJV/trycksaker/Pdf_rapporter/ra06_32E.pdf

[54] Personal communication with the author from the Swaziland Sugar Association chief executive, Dr Michael Matsebula.

[55] Had assistance to the Cameroonian banana sector under the special programme of assistance been made conditional upon broader government policy reform, it might not have been delivered early enough to ensure the productivity and yield gains which have enabled the Cameroonian banana industry to expand its share of the EU banana market considerably since 1992. This would potentially have had serious consequences since there would have been no incentive for the private sector to make investments in banana production given the difficult macro-economic and governance context.

[56] Symptomatic of this was the report on Radio Jamaica's website that CARICOM had issued a call to the EU to release pledged funds to sugar producers, since it was felt continued delays could affect important projects in the Caribbean which aim to modernise and help diversify the sugar industry. It should be recalled in this context that the first pledges of support were made in January 2005 during Trade Commissioner Mandelson's visit to the Caribbean region and the money has been legally available for deployment since January 2006. EC officials were reported as indicating that they expected the money to reach Caribbean countries in the middle of 2007. See report at http://www.radiojamaica.com/news/printpreview.php?category=6&story=31920

[57] See press reports in the *Barbados Advocate* (14 January 2005):
http://barbadosadvocate.com/NewViewNewsleft.cfm?Record=19989 and the *Daily Nation* (Barbados, 10 January 2005): http://www.nationnews.com/StoryView.cfm?Record=56821&Section=LO

[58] The EC argues that market-access restrictions on ACP exports now exist on only 4.23% of their total exports and this implies that there is little room for further improvement. However, this is something of a misrepresentation, in a context where 75% of ACP exports are of products on which the MFN rate is zero. This means that the ACP could enjoy margins of preference on only 25% of the products they export to the EU. Thus market-access restrictions exist on nearly 17% of those products on which the ACP could enjoy some margin of tariff-preference over other third-country suppliers.

[59] Unfortunately while as early as October 2003 the EC held out the prospect of such a measure, proposing before the Article 133 Committee that upon the entry into force of EPAs all ACP countries

should be granted EBA-equivalent access, this prospect is rapidly receding, with growing insistence on special arrangements in sensitive sectors in the short and medium term (up to 2013).

[60] For summary details see the EC press release (IP/06/1824-18th December 2006) http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/1824&format=HTML&aged=0&language=EN&guiLanguage=en; and the EC memorandum on the proposal (MEMO/06/497-18th December 2006) http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/06/497&format=HTML&aged=0&language=EN&guiLanguage=en

[61] As Prime Minister Juncker of Luxembourg pointed out with reference to economic reform in Europe "we all know what we need to do, we just don't know how to win the election afterwards".

[62] However, it should be recalled that in the worst-affected countries an expansion of assistance flows in response to the impact of preference erosion can come to overload government administrative capacities unless extremely simple aid-deployment procedures are set in place. This suggests a need, wherever possible, to use the capacities of non-state actors in delivering support, wherever these exist, so that government capacities can be focussed on managing the external aid flows in support of meeting the challenges of preference erosion.

[63] See the Scenar 2020 study for details at: http://ec.europa.eu/agriculture/agrista/2006/scenar2020/final_report/scenar2020final.pdf .