



EC Sugar Dispute

One Last Stand for a Retiring Regime

John Tabari

After World War II, Europe advocated an intense campaign to secure food security. Accordingly, the European Commission (EC) formed the sugar regime in 1968, which consisted principally of granting direct and indirect subsidies to European sugar producers. Since then, the regime stood the test of time enabling the EC to become the largest exporter of the good. However, in recent times, Brazil, Thailand and Australia have become significantly more efficient at producing and exporting raw sugar than the EC. These countries complained that the EC regime enabled the EC sugar producers to export their sugar to world markets at a price below the cost of production. This led to a reduction of the world sugar price causing damage to these countries' earnings and competitiveness in world sugar markets. That is to say, the EC was contested to be dumping its sugar on world markets. The complaining parties were supported by the WTO rulings, which proclaimed that an effective reform of the regime was required after all these years. This paper investigates the key aspects of the dispute.

What is the Dispute?

WTO members made a commitment under the Agreement on Agriculture (AoA) to reduce subsidies on agricultural exports, setting out a particular reduction commitment level for each Member (provided in each member's schedule). Brazil, Australia and Thailand (the complaining parties) contended that the EC regime provided export subsidies on about 4 million tonnes of sugar between 2001 and 2002, of which more than 2.5 million tonnes of sugar, namely C sugar, was in excess of the EC's reduction commitment level; C sugar being one of the three sugar quotas (A, B and C) set out by the EC regime (refer to Box 1). Article 9.1 of the AoA outlines which export subsidies are subject to reduction commitments. The Panel reasoned that the subsidies used by the EC regime translated to subsidies in the form of 'payments' as described by Article 9.1(c) of the AoA. The Panel considered that subsidies to A and B sugar quotas effectively amounted to a transfer of financial resources to C sugar, and so C sugar was actually being subsidised (a process called cross-subsidisation).

It was unequivocal that any subsidies to C sugar would clearly amount to export subsidies on that commodity in view of the fact that the EC regime demanded that EC sugar producers export C sugar. As a consequence, it was established that the EC regime directly conflicted with AoA Article 3.3, which requires a member not to provide export subsidies in excess of reduction commitments.

At the same time, the EC regime was challenged in the way it employed footnote 1 (the footnote) to its schedule whereby the EC claimed that the 1.6mn tonnes of sugar quota exports, originating in the Africa, Caribbean and Pacific countries (ACP) and India, were not to be included for reduction commitments and were open for enlargement. The complaining parties successfully demonstrated that such a consideration would be in conflict

with AoA Article 8, which affirms that if a member provides export subsidies it must comply with both the AoA provisions and the export subsidy reduction commitments provided in its schedule. In response, the Panel found the EC regime to be guilty on all charges (Panel Report, EC Sugar, paragraph 8.1). Thus the EC appealed against the findings of the Panel before the Appellate Body (AB) on April 28, 2005.

Burden of Proof

Article 10.3 of the AoA lays the burden of proof upon both parties in this type of dispute. Hence, the complaining parties must bring forth evidence that the EC exceeded its quantity commitment levels on sugar exports. If this evidence is valid, then to prove non-violation of AoA provisions, proof must be shown by the EC that it did not provide subsidies to these excessive exports. It must be noted that this approach to the burden of proof is quite unusual. Often, it is the complaining parties who are burdened with providing all proof that the Appellant's measure is inconsistent with the WTO provisions.

Canada Dairy Case

This dispute is similar to the Canada Dairy case where the AB found Canada to have provided export subsidies on milk and dairy products in excess of their reduction commitment levels. The AB ruled that a member must not only be found exceeding its reduction commitment level of exports of an agricultural product to be in violation of AoA provisions, but also that the member must have provided subsidies on these excessive exports.

In this sugar dispute, the EC appealed against the Panel's interpretation of its export subsidies regarding 'payments' in the form of sales to C sugar, which held that these subsidies were 'financed by virtue of government action'. The AB in the Canada case offers direction on certain issues that need

Workings of the EC Sugar Regime

Extraordinarily, the EC sugar regime has had little amendment since 1968, and was even left out of the Common Agricultural Policy (CAP) reform process in 1992. The regime applies to cane and sugar beet, which are transformed to raw and/or white sugar. The EC regime divides their total quota amount between A sugar (11.8 million tonnes) and B sugar (2.5 million tonnes). These two quotas comprise the limited quantities entitled for domestic price support and export subsidies. The same sugar quotas were allocated to the EC members, valid for the years 2001-02 to 2005-06.

The EC sugar exports produced under quota are granted a subsidy roughly equal to the difference between the international and EC market prices. In fact, the cost of the regime amounted to almost US\$1.75bn in 2002. Europe's farmers and producers are the world's biggest recipients of sugar subsidies. In contrast, C sugar, which is any sugar produced in excess of the total quota

stated above, is deemed not to receive export subsidies. The EC regime asserts that C sugar must be exported at the sugar and beet producers' own cost without subsidies.

The EC schedule limits its export subsidies on sugar to 1.2 million tonnes and at a budgetary outlay of US\$5.83mn per year.

In addition, the EC has preferential agreements with the ACP and India, whereby it must import 1.29 million tonnes (white sugar equivalent) of cane sugar from the ACP and 10,000 tonnes of cane sugar from India. Moreover, this cane sugar is imported at zero duty and at guaranteed prices. The disputed footnote to the EC schedule asserts that the EC schedule reduction commitment levels do 'not include exports of sugar of ACP and Indian origin on which the Community is not making any reduction commitments. The average of export in the period 1986 to 1990 amounted to 1.6 (million tonnes)'.

Source: Panel Report, EC Sugar, paragraphs 3.1-3.15, Council Regulation (EC) No. 1260/2001 on the common organisation of the markets in the sugar sector, 2001 and Section II, of Part IV of the EC's Schedule

consideration to ascertain whether the EC regime was found to be providing subsidies on its sugar exports. The AB held that there must be a 'demonstrable link' between the 'process' by which payments are financed and governmental action taken (AB Report, Canada Dairy, paragraph 130). Even though this government action is essential, it does not have to play a significant part in financing such payments. Nevertheless, it must at least play an important role in the process by which a private party funds such payments that a tight 'nexus' can be recognised between the 'governmental action' and the 'financing'. What's more, the AB found it relevant to decide that such a demonstrable link must be identified on a case-by-case basis, taking account of the particular governmental action at issue and its effects on payments (AB Report, Canada Dairy, paragraph 115).

The Size of EC's Reduction Commitments

The EC argued that its quota reduction commitment level for sugar export included the 1.27 million tonnes per year identified in its schedule and the 1.6 million tonnes within the footnote, which it claimed was able for expansion. The Panel articulated that this demand would translate to the exemption of the quota specified in the footnote from reduction commitments, which was not feasible under the AoA.

The EC appealed against this interpretation on the footnote by the Panel. The member put forth that the second sentence of the footnote enforced a limitation of subsidies on sugar exports of Indian and ACP origin. The AB opposed such an argument indicating that the first sentence primarily states that the EC is not making 'any reduction commitments'. Interestingly, the AB questioned why the EC had failed to inform the WTO Committee on Agriculture (CoA) while the AoA was being implemented (interpreting

the footnote to be a limitation on sugar export subsidies). The AB asserted that the EC appeal was weakened in this regard by not having notified the CoA (AB Report, EC Sugar, paragraph 187).

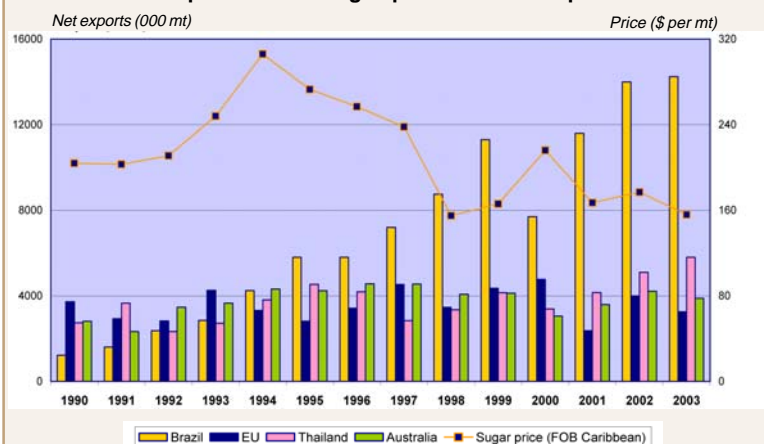
Cross Subsidisation from A and B Sugar to C Sugar

EC sugar regime's regulatory instruments, price support mechanisms and direct subsidies, on A and B sugar were proven to facilitate the cross subsidisation of C sugar. In effect, the EC was controlling the price of A and B sugar and controlling the internal supply of A and B sugar through quotas. High guaranteed domestic prices

Dynamics of the World Sugar Supply

The EC is a major power in the world sugar market, being the only party that is not merely a high producer of raw sugar but also a major importer and exporter of the good. In fact, only Brazil and India produce more raw sugar and at the same time only Brazil, Australia and Thailand export more than the EU. Bearing that the parties to the dispute account for 55 percent of the total world sugar exports, it indicates that this, indeed, was a battle between the heavy weights of the world sugar markets.

Graph 1: World sugar price and net exports



Source: EUROPA, 'EU sugar sector: Facts and figures', 2004 & Huan-Niemi and Kerkelä, 'Reform in the EU Sugar Regime: Impact on the Global Sugar Markets', European Association of Agricultural Economists, 2005, 2005

Flashback - The Expiration of the Peace Clause

The 'Peace Clause' (Article 13 of AoA) was an agreement between members to desist from challenging each other's subsidies on agricultural commodities; hence protecting existing subsidies on agricultural goods and providing special immunity to subsidy providers. The request by EC and US, for an extension of the clause's expiration, was rejected. The expiration of the clause came to pass on December 31, 2003; it was the deep breath before the plunge. The forecast by the EC and the US, suggesting that they were going to be challenged for many agricultural subsidies inconsistent with WTO law, can now be seen to be accurate. Both this EC sugar dispute and the US Cotton case demonstrate that peace has certainly ceased, the pieces are moving and the battle against export subsidies on agricultural products is well under way.

for A and B sugar were found to subsidise C sugar exports. These high prices enabled EC sugar producers to sell C sugar below the average total cost of production, since surplus revenues from A and B sugar allowed them to retrieve a proportion of their fixed costs on C sugar. The Panel deemed this maintained a 'demonstrable link' between 'government action' and the transfer of financial resources to C sugar farmers. As a whole, in support of the Panel's reasoning, the AB declared 'The continued production of such large volumes of over-quota sugar, at prices well below its cost of production, could not take place but for governmental action' (AB Report, EC Sugar, paragraph 248).

The AB reasoned that in the special circumstances of this case, 'payments' within the meaning of Article 9.1(c) could be viewed as a transfer of resources within one economic entity. The AB portrayed EC would accept that a 'payment' would have taken place if A and B sugar producers and C sugar producers were two distinct legal entities. But the AB believed that an internal transfer of economic resources had taken place within one economic entity, i.e. between A and B sugar production, and C sugar production, as all three types of sugar were on the same line of production. The AB believed that a transfer of financial resources had occurred even though it was within one economic entity. Hence, it does not matter whether resources are transferred between two or more economic entities, or within one economic entity, either situation would be covered under the AoA Article 9.1(c) (AB Report, EC sugar, paragraph 265).

'On the export of an agricultural product'

EC appealed that any form of domestic support would be seen as an export subsidy after the decision made by the Panel (ruling that the 'payments' by the EC at issue are 'on the export'). The AB disagreed and highlighted that spillover effects can arise where WTO consistent domestic support may lead to the benefit of export production (AB Report, EC sugar, paragraph 279). This particularly concerns agricultural products for both domestic market and export market, which are often produced on a single line of production. Although the AB asserted that its reasoning was specific to the circumstances of the case, domestic support on many other agricultural products may be disputed against under such reasoning.

AB's Verdict

As a result of the aforementioned AB's overall reasoning, it is clear that the Panel's original major findings were upheld to the dismay of the EC. The ruling of the AB provides the opportunity to effectively relinquish other domestic regulations, currently in place, that are viewed to be providing cross subsidisation on exports, which exceed the required reduction commitment levels in a member's schedule. Consequently, many developed countries will have to reform their domestic policy to be in compliance with this AB reasoning, given that many are providing government subsidies in such a fashion like the EC, which would be challenged at the WTO. For instance, at present the US provides government support to its producers of various agricultural commodities e.g. corn, sorghum, wheat, rice, barley, oats, soy beans and minor oilseeds that enables them to export their goods at prices significantly below the fully allocated cost of production (Powell and Schmitz, 'The Cotton and Sugar Subsidies Decisions: WTO's Dispute Settlement System Rebalances the Agreement on Agriculture', 2005). It must be noted albeit the AB delivered its findings based on the specific facts and circumstances of this dispute, which may allow room for additional argument by developed countries in defence of their policies.

Who Won and Who Lost?

The EC lost on all counts including that its sugar regime must be transformed to comply with the AoA provisions. The rewards of the AB reckoning are to be exploited by the successful complaining parties that will benefit from an increase in world prices once the EC regime terminates its subsidies on its excessive sugar exports. However, the consequences of the verdict remain uncertain for the third parties of the dispute including the ACP, which may perceive its vital preferential agreements with the EC regime to be affected.

ACP Livelihoods: Out of the Frying Pan and into the Fire?

It is important to recognise that a rapid and significant reform of the EC regime will inherently affect the ACP countries. Indeed, when the EC fully commits to the WTO rulings, it is likely the world sugar prices are to rise, which will increase sales for competitive exporters. However, ACP countries' exporters are prone to be ousted from these sales in the short term by larger and more efficient exporters from Brazil, Australia and Thailand. The great worry for ACP countries is that any significant change in their preferential agreements with the EC regime will disturb many livelihoods within these developing countries.

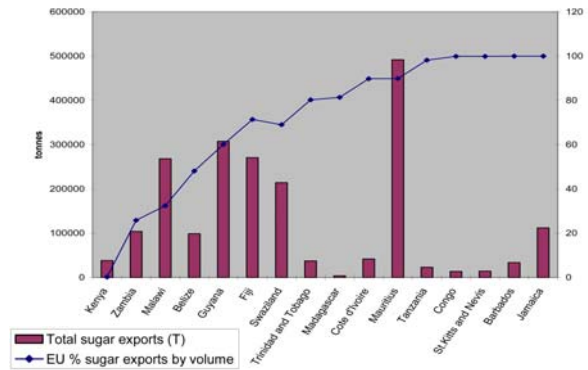
Mauritius has been allocated an EC import quota of about 490,000 tonnes of sugar, which in fact is the largest EC import quota given to any of the ACP countries, representing around 38 percent of ACP quota allocated by the EC. In consideration of the fact that 89% of Mauritian sugar exports go to the EC, the expected revenue loss for Mauritius from the EC sugar reform is expected to be around €100 million (Chaplin H. & Matthews A., 'Coping with the Fallout from Preference-receiving Countries from EU Sugar Reform,' *Journal of International Law and Trade Policy*, 2006). Notably, it is also obvious that this loss of revenue outweighs the €40 million that

the EU is willing to offer in its assistance plan to ACP countries (refer to Box below).

Guyana is in the same position where about 150,000 people earn their livelihood from sugar and at least 15 percent of GDP is earned from the sugar trade. Guyana expects a reduction in EC guaranteed sugar prices, which will cost at least US\$40mn in export revenues, significantly more than their debt relief, which stands at US\$8mn set by the G8 in July 2005 (Medicine Masiwa study: Tradescence in Zimbabwe).

The influence of the EC regime reform will be heavy handed without proper assistance. Mauritius and Guyana should not be viewed as unique cases; there are many ACP developing countries in the same boat. These countries are illustrated on the following graph, which

highlights the total sugar exports by ACP countries and the proportion of these exports going to the EU:



Source: Chaplin H. & Matthews A., 'Coping with the Fallout for Preference-receiving Countries from EU Sugar Reform,' *Journal of International Law and Trade Policy*, 2006

The EC Sugar Regime Reformed

As a result of the WTO AB final verdict and with agricultural negotiations at the WTO ministerial conference in Hong Kong on the horizon, the EC announced the reform of its sugar regime with the following proposal in November 2005:

- 36 percent price cut over four years beginning in 2006/07 to ensure sustainable market balance, -20 percent in year one, -27.5 percent in year two, -35 percent in year three and -36 percent in year four.
- Compensation to farmers at an average of 64.2 percent based on the final price cut of 36%.
- In those countries giving up at least 50 percent of their quota, the possibility of an additional coupled payment of 30 percent of the income loss for a maximum of five years, plus possible limited national aid.
- Merging of 'A' and 'B' quota into a single production quota.
- Voluntary restructuring scheme lasting 4 years for EU sugar factories, consisting of a payment to encourage factory closure. This payment will be 730 euros per tonne in years one and two, falling to 625 in year three, and 520 in the final year.
- To maintain a certain production in the current "C" sugar producing countries, an additional amount of 1.1million tonnes will be made available against a one-off payment corresponding to the amount of restructuring aid per tonne in the first year.
- ACP countries which need it will be eligible for an assistance plan worth €40 million for 2006, which will pave the way for further assistance

Source: EU Press Release 'EU radically reforms its sugar sector to give producers long-term competitive future,' November 24, 2005

Whether this boat stays afloat is dependent on the hope of constructive technical assistance and capacity building and the opportunity, if any, to transfer livelihoods into other occupations such as tourism and other services.

Conclusion

The ruling compelled the EC regime to align its sugar regulations with respect to WTO law. The EC modified its regime by cutting the guaranteed domestic price for raw sugar by 36 percent over a four year period, beginning in 2006. This would reduce high surplus revenues from A and B quota sugar being transferred to C sugar, and so eliminate the cross subsidization of C sugar exports.

The most significant outcome is that the EC shall become a net importer again, as it was 30 years ago, by fully complying with the WTO ruling. The reform of the EC regime will affect world sugar prices to a certain extent, with Brazil, Thailand and Australia being comparable exporters. Nevertheless, the EC will no longer be the second largest exporter of sugar in the world market. This title will be awarded to Thailand at current status (Australian Department Foreign Affairs and Trade, WTO Dispute, EC sugar). Therefore, it also may be a special opportunity for developing countries to strengthen their relationships for example, Thailand, Brazil and India under improved South-South trade.

Ultimately, the AB ruling may lead to the promotion of more challenges being prepared by members, with the purpose of hastening agricultural reforms through the dispute settlement process. Such action could become a preferable alternative to the negotiations in the Doha Round, which can be seen to prolong such revolution of the World's agricultural markets.

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This Briefing Paper has been researched and written by John Tabari of and for CUTS Centre for International Trade, Economics & Environment, D-217, Bhaskar Marg, Bani Park, Jaipur 302 016, India, Ph: 91.141.228 2821, Fx: 91.141.228 2485, E-mail: citee@cuts.org, Web Site: www.cuts-international.org, www.cuts-citee.org. The author would like to thank Dr. Aradhna Aggarwal, Professor Ricardo. I. Beltramino, Professor Mitsuo Matsushita and Dr. Eduardo Bianchi for their valuable comments on the paper.