GOVERNMENT RESPONSE TO THE HOUSE OF LORDS EUROPEAN UNION COMMITTEE'S REPORT ON THE EU SUGAR REGIME

Introduction

From the start of the current negotiations on the reform of the Common Agricultural Policy (CAP) sugar regime, the UK Government has pressed for liberalisation.

Market distortions arise from both production quotas for EU sugar beet and very high tariffs on imports of sugar cane. As a result, wholesale sugar prices for EU food and drink manufacturers has been inflated by around 35%, while EU consumers have suffered a 1% increase in the overall cost of the average food basket. At the same time, producers in many poorer countries find it difficult to market their sugar in Europe, hindering their economic development, and undermining to some extent the EC's own aid programmes to these countries.

The Government therefore welcomes their Lordships' careful consideration of the issues at hand ahead of the conclusion of the CAP reform negotiations. There is a good fit between the conclusions and recommendations in the report and the UK's negotiation position.

Since the European Union Committee's report was published, negotiations on CAP reform have proceeded apace, and we are now entering the trilogue between the Council, the European Commission and the European Parliament. This response takes account of the current state of negotiations, and the stated positions of each of these institutions.

Developments since the 2006 reform

In assessing the impact of the reform, we are particularly mindful of the Court of Auditors' concerns about the extent to which any benefits of the reform have been passed on to consumers. The key message moving forward is that the market cannot be predicted with any degree of certainty and therefore that the EU's sugar policy must be sufficiently agile to respond appropriately. (paragraph 21)

We agree with this concern, which has been a key driver of the UK's negotiating position. EU policy, and specifically the quota regime, has exacerbated price volatility and hence uncertainty in the market.

Future reform- internal policy

We are very concerned that the 16 per cent net increase in the EU price for sugar since 2006 has not been reflected in consumer prices for sugar and related goods, which have risen by over one third in the UK. We find the argument that the consumer price could fall if production

quotas and tariffs are removed compelling but this requires monitoring by the European Commission. It is disappointing that the recent evaluation by the Commission of Common Agricultural Policy measures applied to the sugar sector assesses the impact on all groups except consumers. In line with the objectives of the Common Agricultural Policy as set out in the Treaty, we urge the Commission to put the consumer much closer to the heart of its sugar policy and, specifically, to put in place a mechanism to assess not only the market price of sugar but the price paid by consumers. (Paragraph 28)

We agree. We have used every opportunity to raise awareness of the impact on consumers in discussions with the Commission, other Member States and the European Parliament, using our economic model of the impact of the current regime and reform proposals on consumers.

We note from the Commission's own response to the report[1] that it was expecting a study on price transmission in the sugar sector to have been completed in February and published. When it is eventually published, we will ensure that the Committee is informed.

We conclude that neither the beet nor the cane sectors should continue to be protected. We therefore agree with the UK Government both that production quotas should be abolished in 2015 as proposed by the Commission and that import tariffs on raw cane sugar should be eased as appropriate in response to the world market. The easing of tariffs should, in our view, be extended to the import of refined cane sugar, bearing in mind the need to provide some security of supply, world trade discussions and support measures applied by other countries to support their sugar markets. The current restrictions on exports from the EU should be lifted to allow the EU to compete on the world market and to provide balance in the EU market if imports were to increase further. Paragraph 31)

This recommendation covers three elements of the reform.

As far as ***beet quota abolition*** is concerned, the Agriculture Council mandate agreed in March 2013 extends quotas to 2017, while the European Parliament agreed an amendment pushing that date back to 2020. The UK does not want to see any further slippage beyond 2017. This date would give EU beet processors and developing countries a further four years in which to benefit from the current artificially high prices and begin adjusting to more normal market conditions.

Regrettably, and despite the UK Government's best efforts, neither the Council nor the European Parliament have included measures to address the perilous position of EU cane refineries once beet quotas are abolished. We believe this is a serious omission. Having at least two sources of sugar in the

[1] Published in March 2013, and available from http://www.parliament.uk/documents/lords-committees/eu-sub-com-d/sugar/commission-response.pdf

EU is good for the EU's competitiveness and for food security, and the continued operation of EU refineries is important for a number of developing countries.

While removing quotas will drive market prices down, high tariffs would continue to restrict the volume of sugar that it is economically viable to import, and therefore would hinder efficiencies of scale in refiners' operations. EU trade agreements should increase the supply of sugar cane in due course. However, there is likely to be a very difficult transitional period when the viability of EU refineries, including Tate & Lyle in London will be threatened. We strongly believe that the sugar beet and sugar cane industries should be afforded the opportunity to compete on an equal basis. We are committed to continuing to work with the European Commission and others so that this issue to be properly recognised, and addressed, in the wider background of the trilogue process.

Finally we share the Committee's wish to see a final CAP reform agreement that would allow the EU to export sugar without restriction.

While we urge the Government to continue to advocate a more liberalised approach as early as possible in negotiations, we recognise the political reality of the agricultural reform negotiation. However, we would consider a simple continuation of the status quo to be unacceptable. (Paragraph 32)

We agree. As the report notes, the negotiations are complex, and participants hold a wide range of views on the sugar regime, most of which are opposed to some extent to the full liberalisation which the UK has been advocating.

In the event that a compromise should be necessary, we would recommend the following elements:

- **a clear date for the ending of production quotas between 2015 and 2020. We would resist any promise of a future review in order to establish a final date as this fails to give the industry the certainty that they claim to require in order to make appropriate investment;**
- **an immediate recalibration between Member States of production quotas to recognise changes made both pre–2006 and since 2006; and**
- **support to remove inefficient production. (Paragraph 33)**

We agree with the first recommendation wholeheartedly.

While we see the merits of the second recommendation, we believe it would distract from efforts to secure our main aim i.e. a definitive end date for quotas.

We disagree with the recommendation that the final agreement could include support to remove inefficient production. As noted in paragraph 4 and Box 2 of the report, funding to the tune of €6.2 million was provided for this purpose as part of the 2006 reform, through a levy on all beet sugar processors. It seems that, even with significant compensation on offer, the political imperative in some Member States was to retain inefficient production. Setting targets for reduced production can then lead to the removal of relative efficient sectors of the EU industry. We do not see a good justification for spending the European consumer's or taxpayer's money on further restructuring, particularly if – as is likely – the industry has a few more years beyond the proposed abolition date of 2015 to adapt.

From the consumer's perspective, though, funding has already been used to dismantle some of the sugar quota capacity and we therefore recognise the lack of consistency in any move to increase sugar quota gradually. We would not recommend an increase in sugar quota as a form of compromise. (Paragraph 34)

We agree and are pleased to report that this has not formed part of the negotiations to date.

We remind the Council and the European Parliament that the reform of the sugar sector must be seen in the broader context not only of Common Agricultural Policy reform but also of the future cohesion policy. The potentially large-scale alternative use of beet sugar in bio ethanol production—rather than for human food or animal feed—is another important consideration on which we would welcome the Government's response in the UK context. When designing future rural development plans and operational programmes for structural funds, the nature of Member States' sugar sectors might usefully be borne in mind. (Paragraph 35)

We agree with the Committee's recommendation that potential non-food uses for sugar beet need to be borne in mind. Currently, the biofuels market is mainly supplied by the surplus beet grown over and above the UK's quota allocation. This varies from year to year depending on the harvest.

The quota system does per se not impede growth in this area. Market prices and other incentives, rather than the Common Agricultural Policy, will determine the amount that gets planted, and the share of each outlet.

One justification for continued protection of the sugar beet industry is the difficulty of facing the volatility of the world market, a danger that could be mitigated by greater use of risk management tools, such as insurance but extending also to future pricing. We understand that such tools are under developed in the sugar sector and we therefore recommend that the European Commission submit a report, with recommendations, on the use and development of private sector risk management tools in the sugar sector. (Paragraph 36)

In its response the Commission refers to its proposals, in the context of CAP reform, for a revised Rural Development Regulation which would cover, amongst other things, new risk management tools. These include three new measures on risk management: insurance; mutual funds; and an income stabilisation tool. It is not clear at this stage what will be included in the final Regulation, but mutual funds and insurance are likely elements.

The UK Government's view is that there are a range of activities that could be used to support farmers manage their risks, and we should not focus solely on the particular tools mentioned.

In England, we are currently considering the range of activities that the next Rural Development Programme could support. That consideration will includes a robust multi-criteria analysis to ensure that money is spent where it can deliver the greatest impact.

Whilst the market remains regulated at EU level, there is clearly a role for market management measures, including tariffs and import quotas. There is dissatisfaction with the manner in which the Commission has discharged its responsibilities. We observe that the Commission has at least attempted to balance the interests of the beet production and cane refining industries. It must continue to do so and to ensure that its decisions are taken in a timely and transparent manner. Transparency is important as tariffs form part of the EU's budget and therefore substantial reductions in tariffs have wider implications for the financing of the EU budget. (Paragraph 40)

While it is true that the Commission has sought to balance the interests of the beet and the cane sectors in the way in which it has responded to the shortage in sugar on the EU market, the Government believes it could do more.

The recommendation notes that changes in tariffs could have wider implications for the EU budget. In our view, this needs to be considered in the context of the impact on the competitiveness not only of EU cane refiners, but more broadly on the competitiveness of its food and drinks manufacturers.

Even *reduced* tariffs of €252-€270 a tonne on cane imports represent a very significant premium for refiners. At the present world prices of €290 a tonne, these tariffs are close to effectively *doubling* the price of imports for refiners. It's difficult to see the economic justification for distorting EU prices or deriving revenue in this way, at a potential cost to tax receipts generated from manufacturing.

Therefore, while we welcome the system of tenders introduced since 2011, we would like to see a set volume of can imports available at much lower – and even zero – tariffs.

We observe, as have others, that the nature of the sugar market is unusual and that the EU's sugar regime is a contributory factor. As

already highlighted in this report, the prices paid by consumers for sugar and related goods have not, at least in the UK, followed the trends in the EU market price for white sugar. We accept, as do the Court of Auditors, that pricing in a market such as sugar with a complex supply chain is far from easy to disentangle. It is our view that greater clarity and transparency is required. We therefore recommend that the Competition Authorities at EU and national level, namely the Office of Fair Trading in the UK, in collaboration with Competition Regulators in other EU Member States, investigate the market as it applies to UK and EU consumers, to assess the extent to which the consumer gets a fair deal. (Paragraph 43)

The European Commission has announced that it is making inquiries into suspected anticompetitive practices. [1] In late April 2013, officials from the European Commission and the relevant national competition authorities undertook unannounced inspections at the premises of companies active in the sugar industry in several Member States. The inspections relate to concerns that those companies may have violated EU antitrust rules that prohibit cartels and restrictive business practices, in the context of the supply of white sugar. The Office of Fair Trading (OFT) assisted the European Commission with an inspection in the UK and is monitoring the sector more generally.

At EU level, in the past few years, the OFT and other EU Competition Authorities have been watching closely the consumer goods markets. This is shown, among other things, by a report published a year ago by the European Competition Network (ECN) - the system whereby the Commission and the National Competition Authorities (NCAs) co-ordinate their action. This report provides a comprehensive overview of the most significant enforcement, advocacy and monitoring actions undertaken by the NCAs and the Commission from 2004 to 2011. The report is available at http://ec.europa.eu/competition/ecn/food_report_en.pdf . In addition, it may be worth mentioning that, to have a fuller picture of competitive conditions in food and consumer goods, the European Commission has set up a special Task Force that has been monitoring and will continue monitoring the food supply chain and has been investigating alleged anti-competitive practices at European level as well as recurring allegations that unfair trading practices would impair choice and innovation in the long term.

We consider it unlikely that the Commission desires to undermine the position of growers in this type of relationship but we think it essential that the Commission communicates its intentions. It would be helpful to amend the text of the new Regulation to include the same specificity as is reflected in the current legislation, which might also remove the need to confer the power on the Commission to adopt a delegated act. (Paragraph 45)

[1] Press notice available from http://europa.eu/rapid/press-release_MEMO-13-443_en.htm

We are heartened to see the Commission's confirmation that it does not intend to undermine the position of growers, and the statement that the proposal will follow the current approach.

In our view, basic and applied research in the sugar sector, supported by knowledge transfer, are a key component to driving forward a sugar sector throughout the EU that can stand on its own. We believe that industry must invest in order to boost both research and its competitive position. We therefore recommend that the Government assess whether research efforts in this industry are in line with the needs of consumers. (Paragraph 48)

It's a matter for debate whether Government is best placed to carry such an assessment.

The UK sugar sector funds its own strategic applied research and knowledge transfer through a levy paid by the growers and British Sugar. The BBRO (British Beet Research Organisation) is an autonomous industry body run by industry itself. It is able to submit applied research proposals to the Sustainable Agriculture and Food Innovation Platform and other Technology Strategy Board competitions. It revises its R&D strategy annually, in consultation with the whole sector.

We see the strategic interests served by research as:

- *farmers' competitiveness and profitability*. Key drivers are:
    - yields
    - input costs
    - climate change resilience – the ability for crops varieties and farming systems to withstand changing and more unpredictable weather patterns.

  Research on all three aspects should be in the producers' interests. The sector is therefore best placed to evaluate research efforts.

- *security of supply for end-users and industrial users* (eg food and drink manufacturers) at a price they deem affordable. Yields, input costs and climate change are likely to be key drivers for this too. We would therefore expect a significant degree of convergence between the needs of beet sugar users and those of farmers. Again we believe that the food manufacturing sector is well-placed to assess the alignment of the research effort.

- *environmental protection*. As with other crops, it is important that sugar beet production is as efficient in its use of natural resources (eg water) as possible, and requires as little chemical treatment as possible. Most of these resources have a price, and the impact of their use will be felt through input costs. Therefore it will be in producers' and users' interest to invest in research on this. However, negative externalities for the environment needs to be identified, monitored and – as far as possible – remedied. The market on its own may not provide research on this, and this is an area where a Government watching brief would make sense. However, this would have to be considered against wider priorities in the context of tight resources.

BBRO's objective to "to commission and implement research and technology transfer (grower support) designed to promote a sustainable and environmentally responsible beet sugar industry in the UK"[2] seems well aligned with the strategic interests described above.

ACP/LDC Countries and the EU Sugar Regime

We strongly urge the Commission to ensure that delegations in the ACP/LDC countries are sufficiently resourced and to monitor closely the progress of disbursement of funding. (Paragraph 52)

We agree, and will seek assurances from the Commission that local offices will be adequately staffed to monitor the impact of Accompanying Measures as this programme winds down.

We recommend that Action Plans for the affected ACP/LDC countries should be revisited as soon as possible. Such Action Plans need to be started in the period before 2015 but sufficient time should be allocated to design appropriate plans and build the capacity in recipient countries to implement them. We further recommend that Action Plans should be targeted at issues identified by the countries themselves, such as increasing their competitiveness and efficiency or, where appropriate, moving away from sugar production altogether. (Paragraph 54)

As the Commission's response to the Inquiry intimates, the presumption is that current high world sugar prices and the availability of new markets (particularly in China) mean that Accompanying Measures for the sugar protocol countries will not need to be continued beyond 2013.

For the poorer countries, particularly those in Africa, their expectation is that in future such countries' needs can be met through normal European Development Fund support, which will provide about €30 billion over the years 2014-2020.

Nevertheless the UK will continue to keep the situation under review, and should the situation change (for example, should world sugar prices fall) we will encourage the Commission to see whether special measures should be reintroduced.

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[2] See http://www.bbro.co.uk/policy

We consider that the future price of sugar on the world market is uncertain and that increased exposure to volatility for ACP and LDC countries is likely. (Paragraph 59)

Given the lags inherent in production cycles and the dependence on weather conditions, international agricultural markets tend to be characterised by price volatility. Global sugar markets have experienced marked price swings over recent years and we agree that such volatility may continue in the future.

The Commission will need to work closely with the ACP and LDC countries to determine what mitigation measures are needed beyond 2015. We recommend that such work should be part of decisions on the pace and detail of further reform and that this should involve extensive consultation with representatives of the countries concerned. (Paragraph 60)

We agree, though mitigation measures on sugar should not be considered separately from any country's broader development needs. For the poorest countries (which are the focus of EU aid), needs are captured by revised National Indicative Plans. The Department for International Development and other Member States are working closely with the Commission and host governments as these are worked up.

We therefore recommend that it will be necessary for the Commission not just to consider matters on a country-by-country basis, but to look at the localised impact of changes and support. (Paragraph 61)

We agree, and where appropriate for the poorest countries, regional and district impacts need to be taken into account as National Indiative Plans are developed.

We recognise that it will be necessary for some countries to move away from sugar production altogether and that others will need support to improve their competitiveness and efficiency. We therefore recommend that in determining what mitigation measures are needed beyond 2015, the Commission should consider support for retraining, drawing inspiration from existing best practice where relevant. (Paragraph 62)

We agree, though for good reason EU aid is increasingly focused on the poorest countries. In such cases there is no reason why such support should not be considered as part of the EU's wider response. It should also be noted that similar support is available to a number of developing countries under the Economic Partnership Arrangements that are being taken forward in much of Africa, the Caribbean and the Pacific.

Ultimately, support for developing countries is a matter for development policy rather than agricultural policy. We agree with the Minister that plans for further reform of the EU Sugar Regime have not sufficiently accounted for the likely impact on ACP and LDC countries and appear to have been taken in isolation from discussions on future development

policy. We recommend that the Government vigorously pursue this issue during negotiations on the Commission's agriculture and development proposals for the period 2014–2020. (Paragraph 64)

We strongly agree, and the Commission's response to the Inquiry's finding also supports such an approach. The Department for International Development has been working closely with their counterparts in Brussels as plans for the eleventh round of the European Development Fund (EDF11 – 2014-2020) are worked out, and developing countries' National Indicative Plans finalised. This engagement will ensure that the funding available to EU missions in many of the sugar producing developing countries will support interventions which have most impact on poverty reduction, job creation, and economic growth.

As the Commission's response notes, agriculture is a key priority for EU cooperation in many developing countries. Such funding can also be used to stimulate investment in the associated private sector, adding value in-country to agricultural exports, rather than simply exporting raw commodities in-bulk for processing in the country of consumption. This is increasingly happening in the sugar sector.

We are not convinced that importing an additional 300,000 tonnes of cane sugar will have significant consequences for ACP and LDC producers. However, more Free Trade Agreements are likely to be signed. In preparation for the negotiation of such Agreements, we recommend that the Commission should produce an Impact Assessment of the likely effect on these countries and the EU sugar market before making any further commitments relating to the trade of sugar. (Paragraph 68)

The Commission (DG Trade) routinely produce impact assessments in preparation for any new free Trade Agreement, and these should take account of the effect on sugar producers, not just in the countries concerned but in third countries too.