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The European Union Sugar Industry at World Market Prices

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**A report for the American Sugar Alliance by
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Executive Summary: Lessons in Sugar Liberalization

After more than half a century as a highly regulated sugar policy, with minimum prices and domestic sales' quotas, the European Union's Sugar Regime was liberalized from October 1, 2017. From then on, producers would freely decide how much to supply, a large amount of duty-free imports were available and prices were to be determined by supply and demand. "Market forces" would rule.

The immediate effects of liberalization have been catastrophic for the EU sugar industry and its competitors. Overproduction in the EU and abroad drove sugar prices to record lows. Many farmers and processors alike faced losses for the first time in at least 40 years. Insanely, subsidies allocated to uneconomic sugarbeet areas destroy capacity in competitive areas and increase distortions on an already subsidy-driven world market. Furthermore, low sugar prices have nullified the value of preferential treatment offered to developing countries by the EU.

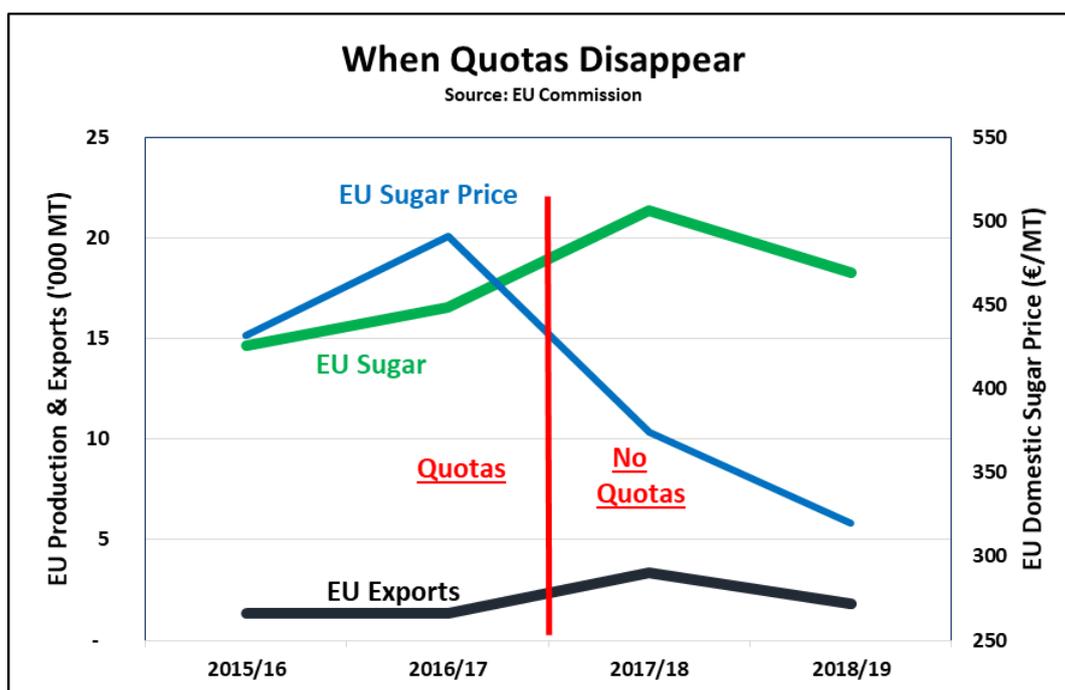
Since 1992, the European Union has sought to bring domestic agricultural commodity prices down to world-market levels. The guiding principle is that farmers should decide what and how much to produce based on their views of expected market prices, not in relation to public incentives targeted at specific outputs. The last two major products to be brought into this "market-oriented" approach were dairy, in April 2015, and sugar, in October 2017. In both these cases, the headline measure was the simultaneous termination of production-limiting quotas and guaranteed minimum producer prices.

For sugar, the immediate consequences were a sharp increase in supply and a drop in prices. This destroyed value for all suppliers to the EU market and shifted margins to branded food processors through lower raw material costs. This was entirely predictable. What was not predicted was the scale of value destruction, as sugar prices dropped to record lows. EU policymakers have not yet taken the full measure of these effects, which contradict other policy aims, harm third parties and may well contravene EU international commitments.

On October 1, 2017, the European Union abolished sugar quotas, which limited the amount of domestic sugar and high-fructose starch syrups sold on the food market, and the guaranteed price for sugarbeet. For the first time in over 50 years, European beet growers and millers became completely free to decide how much sugar to produce and sell, and the price for sugar was determined essentially by supply and demand. Largely, the European sugar industry was liberalized.

Free to seek full capacity utilization to better amortize fixed costs, processors encouraged growers to increase beet plantings. Furthermore, a few large and efficient players hoped to smother weaker EU competitors under an avalanche of low-cost sugar. In the event, beet acreage increased 18.5% and beet-slicing time grew from 92 days to 130 days on average. Combined with record yields driven by exceptionally favorable weather, area growth brought about an unexpectedly large 29% surge in supply. Production reached a record 21.3 million metric tons (MMT¹) against 17.6 MMT in the previous, quota-limited, crop year².

This EU sugar production surge flooded the EU market and pushed ex-factory prices for refined sugar down from an average of EUR 525 per ton in 2016/2017 (27 US cents/lb³) to EUR 425/t in 2017/2018 (22 cents/lb). Low prices and an exceptionally warm 2018 summer helped domestic demand increase by 4% to 18 MMT. Nonetheless, prices remained on a downward trend, hitting EUR 312/t in January 2019⁴ (16 cents/lb – refined, bulk, ex-mill).



With the end of quotas and of the minimum beet price, the WTO-imposed 1,374,000-ton limit on EU exports was lifted, so that the supply surge caused a 50% increase in exports. Thus, internal market balances drove domestic prices towards export-parity, an unprecedented development for the modern European sugar industry.

¹ Unless otherwise specified, this report uses the metric system for weights. Reminder: 1 metric ton = 1.10231125 short tons.

² The EU crop year runs from 1 October to 30 September.

³ Throughout this report, “cents” means US\$ cents.

⁴ This report uses 1 euro = 1.13 US dollar for the €/€ exchange rate.

Even without the need to export excess sugar, however, EU sugar prices would have been influenced by exceptionally low world market prices. That is because some 2.5 MMT are available to import free of duty⁵ to fill a much smaller deficit and because this duty-free sugar is arbitrated against the world market: competition between duty-free suppliers drives down the price of imports to world market levels, which are traditionally below most producers' cost of production.

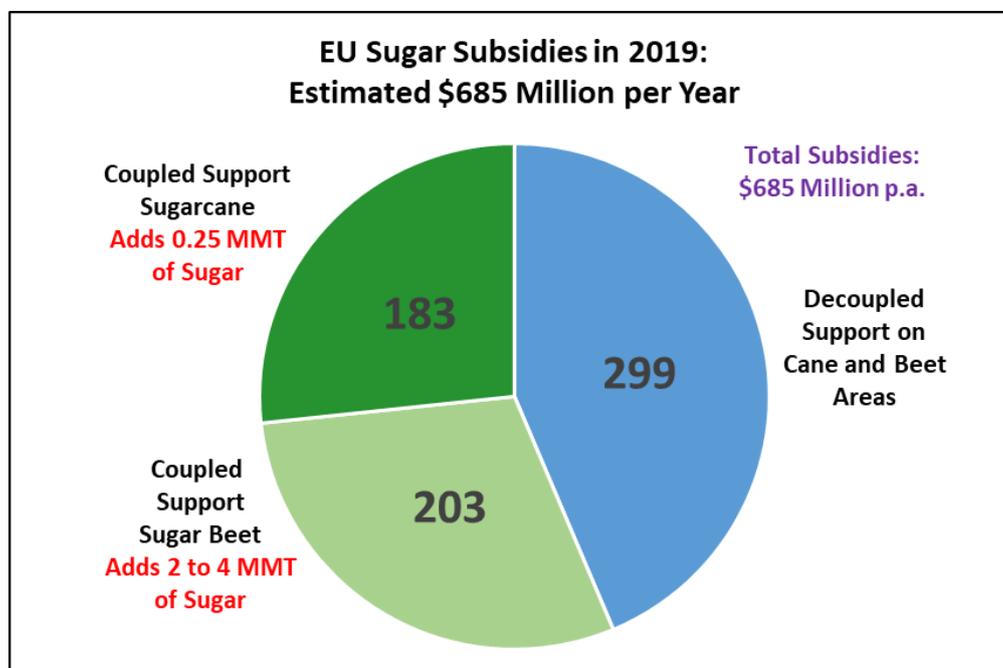
With sugar income well below 20 cents per pound, processors and beet growers alike have seen drastically reduced margins and even losses.

Large, competitive and well-run sugar processors, which in living memory had not experienced low or negative net income, turned out disastrous financial results. Financial markets reacted by cutting valuations for shares and debt instruments. To slash fixed costs and ensure remaining factories slice for as long as possible, sugar processors are closing factories.

EU sugarbeet growers, who plant sugarbeet more than a year before knowing what income their crop will generate and have inadequate tools to price it in advance, have discovered that beet income may not cover full cost, let alone produce a margin equivalent to alternative crops.

Some EUR 3 billion (\$3.4 billion) has effectively been taken from the beet farming community and given to food processors – with no discernable advantage to the final consumer.

Catastrophic sugar prices are partially offset by continued – but not growing – EU subsidies amounting to some \$685 million annually. EU farmers generally receive a per hectare subsidy, which is disconnected from what particular crop they choose to plant and roughly constant within a Member State. Beyond that, 40% of European growers receive subsidies specific to sugarbeet, which shield them against normal adjustments to market price signals. In outermost EU regions, sugar supply benefits from large subsidies intended to compensate for difficult natural constraints, including expensive logistics⁶.



Sources: EU Commission, French Ministry of Agriculture, ProSunergy estimates

⁵ Composed of some 2 million MT of ACP/LDC export capacity and about 650,000 MT of duty-free TRQs.

⁶ Outermost regions are composed of five French overseas departments — Martinique, Mayotte, Guadeloupe, French Guiana and La Réunion; one French overseas community — Saint-Martin; two Portuguese autonomous regions — Madeira and the Azores; and one Spanish autonomous community — the Canary Islands.

Distributed over a quarter of beet areas, the EU's coupled support for sugarbeet is particularly egregious as it adds between 2 and 4 million tons of sugar which otherwise would not be produced. Against an annual demand of some 18 million tons, this "Voluntary Coupled Support" fundamentally distorts competition, contradicting the EU's contention that its sugar industry is now "market-oriented". It damages unsupported EU producers, developing countries and world market balances. VCS payments have not been challenged yet, but would likely be found illegal under WTO rules.

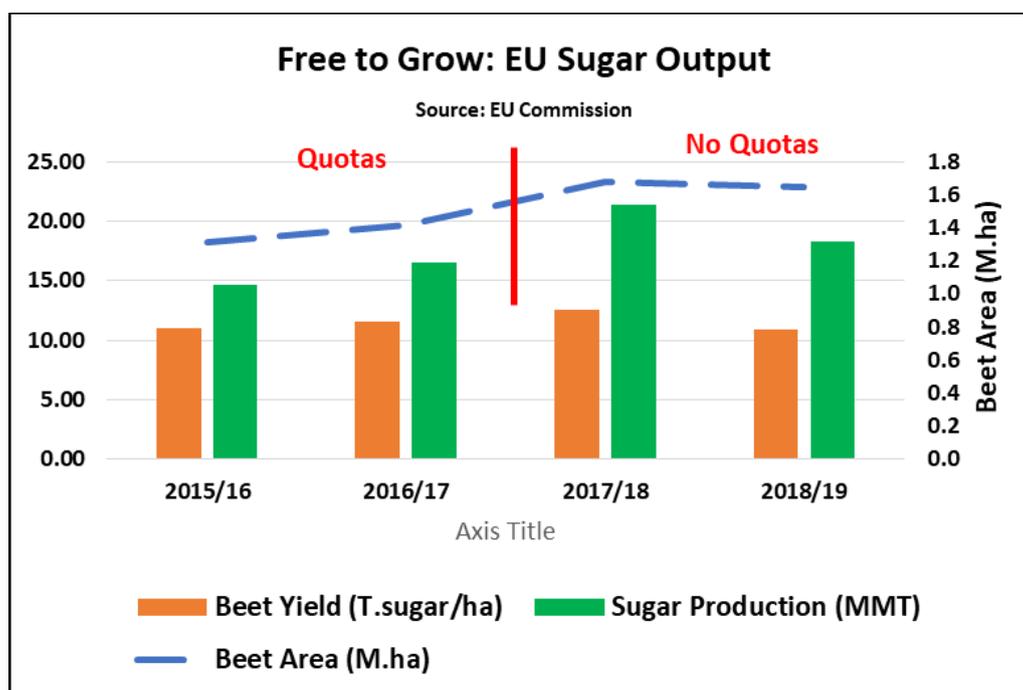
Whilst liberalization remains tempered by continuing subsidies, it is also curbed by European unease at modern genetic and plant-protection innovations. Genetically modified organisms (GMOs) and many chemicals used to improve agricultural yields are viewed with suspicion by large swathes of Europe's public. Politicians have taken notice and implemented regulations that severely constrain their use, sometimes even in cases where science shows these products to be better for the environment. A logical consequence is to impose similar restrictions on imports, both to prevent international competitors alone from benefitting from these innovations and to extend European life-style choices overseas. Inevitably, imports of sugar and sugar-containing products will face stronger EU non-tariff barriers.

Liberalization is a potent tool to ensure efficient allocation of resources, but not when market signals are wrong. EU sugar now operates with fluctuating, distorted and most often depressed world market prices, influenced by widespread government interventions. Not only must its most efficient producers compete with foreign subsidized sugar, but they also face competition from subsidies directed to uneconomic EU beet areas. The industry will shrink, be poorer and weaker.

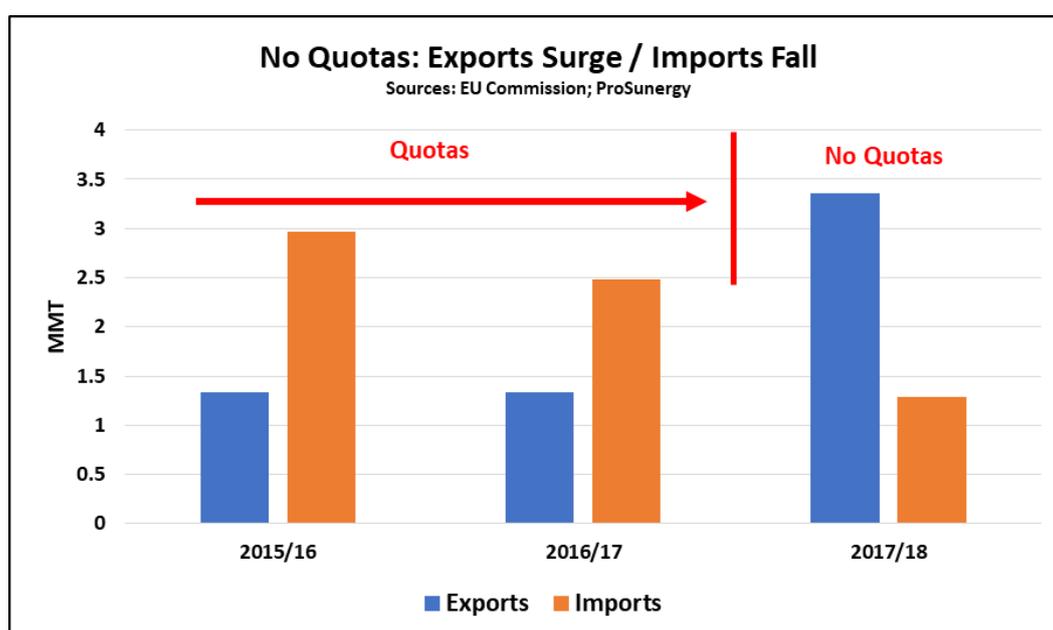
The EU's liberalization of its sugar industry is a lesson in unintended policy consequences: a fundamentally competitive industry is being endangered by domestic and international market distortions.

2017/18: The Perfect Storm

In 2017/18, without quotas to tame its “animal spirits”, the EU sugar industry met nature, world market distortions and political realities. Rightly proud of their competitiveness, EU beet farmers and processors decided to expand. Beet area grew by 18.5%, surprisingly favorable crop conditions drove yields up 9.6% and sugar extraction improved. The result was a flood of additional sugar. Sugar production grew from 16.8 MMT to 21.3 MMT, a record.



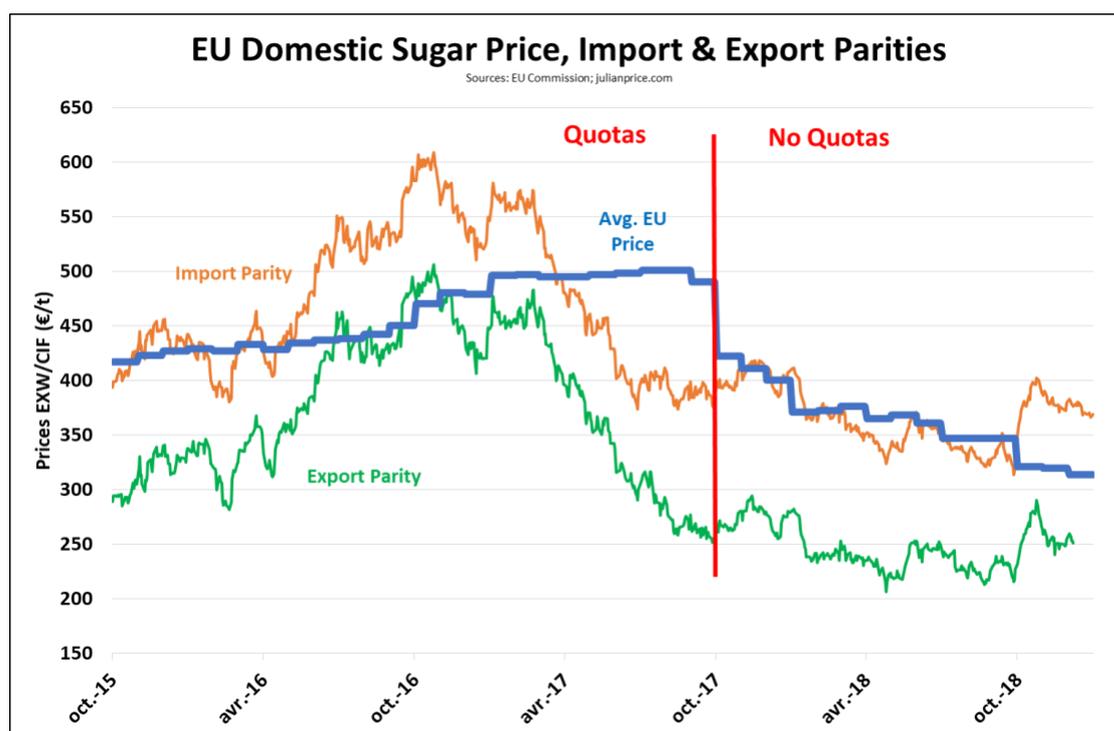
Consequently, imports dropped and exports surged. Lower sugar prices and a warm summer helped domestic EU demand increase, from 17.7 MMT to 19.0 MMT, but the larger domestic consumption could not prevent a surge in exports.



With the disappearance of quotas in October 2017, domestic EU sugar prices fell 14% in relation to September. In effect, prices dropped to import-parity. Most unfortunately, the “perfect” 2017/18 campaign coincided with very low world market prices and, in the absence of domestic market management tools, excess supply dragged internal prices to record lows as sellers competed against each other and against imports.

The EU sugar market is now largely exposed to world market price levels and volatility, despite imports falling structurally as domestic production is freed from quotas. The quota system guaranteed a market for imports of about 3 MMT⁷ per year. Today, the need for imports should fluctuate around one million tons, depending on the size and quality of the EU beet crop. But these diminished imports still impact domestic prices because some 2.5 MMT of foreign sugar are eligible for duty-free access to the EU: even when domestic production is below internal demand (18 MMT), duty-free sugar, which is arbitrated against world market prices, is well sufficient to cover import requirements. Competition between potential duty-free exporters to the EU ensures that EU import prices can diverge from international levels only marginally, despite tariffs on some additional 600,000 tons of imports allowed under TRQs and prohibitive MFN tariffs for all other world market sugars.

As international prices fell and the large 2017/18 surplus worked its way to market, prices for refined sugar in the EU continued to drop, to just above 16 cents/lb in December 2018.



In this price context, both growers and processors are facing financial stress and a difficult future.

Investors recognized the new challenges and processor valuations plunged. The evolution of Südzucker AG’s share price from the end of quotas in October 2017 to the end of March 2019 is telling: it dropped 36%, from EUR 17.90 to 11.41 per share. Südzucker is Europe’s largest sugar producer.

⁷ Average bulk EU sugar imports 2009/10 to 2016/17: 3.2 MMT

Südzucker Share Price Oct. 2017 – Mar. 2019 (Euros per share)



(Source: Yahoo Finance)

Perceived processor debt risk skyrocketed when sugar companies announced deteriorating results, as the evolution of the value of Tereos's 4.125% 2023 bonds shows. Tereos is Europe's second-largest sugar producer. As underlying operations become less profitable, full repayment of the bonds becomes less sure and bond prices fall. Since EU quotas were abolished, the value of Tereos' bonds has dropped over 20%.

Tereos 4.125% 2023 Bonds (Euros)



(Source: Börse Berlin)

In part because of its own hubris, in part because of world market vagaries, in 2017/18 a newly liberalized EU sugar industry met “the perfect storm”.

It must now learn to live with uncertain, fluctuating and low prices.

When challenged by beet growers and sugar processors alike to take measures to alleviate the hardship experienced in 2017/18, EU authorities coolly responded that it behooved operators to adapt to the market. The existence of an EU “reference” price for sugar has no effective bearing on domestic prices. This is true for other Common Agricultural Policy commodities too. The sugar reference price of EUR 404.4 per metric ton (20.7 cents/lb) is only an indicator whether prices are low, unremarkable or high. If prices dip below the reference price, EU authorities have no legal obligation whatsoever to act and, today at least, are determined not to intervene in agricultural markets with short-term corrections.

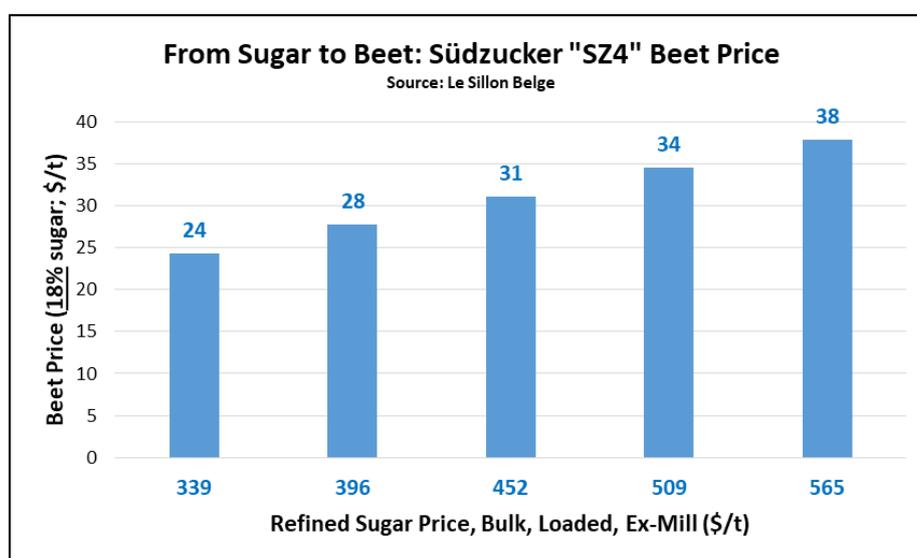
Choppy Waters: Managing in the New Regime

The EU sugar industry now operates within a new paradigm characterized by low and widely fluctuating sugar prices, and in which transport costs strongly influence competition. This favors maintaining a deficit to safeguard import-parity pricing and, given the capital-intensive nature of the industry, calls for a ferocious assault on fixed costs.

Südzucker AG, the largest EU sugar processor (2018/19 sugar production: 4.7 MMT) is a good example of how the industry is adapting to its new environment. It is also a listed company⁸, which therefore must properly inform investors of its situation and intentions.

The first fundamental change is that beet prices are now linked with sugar prices.

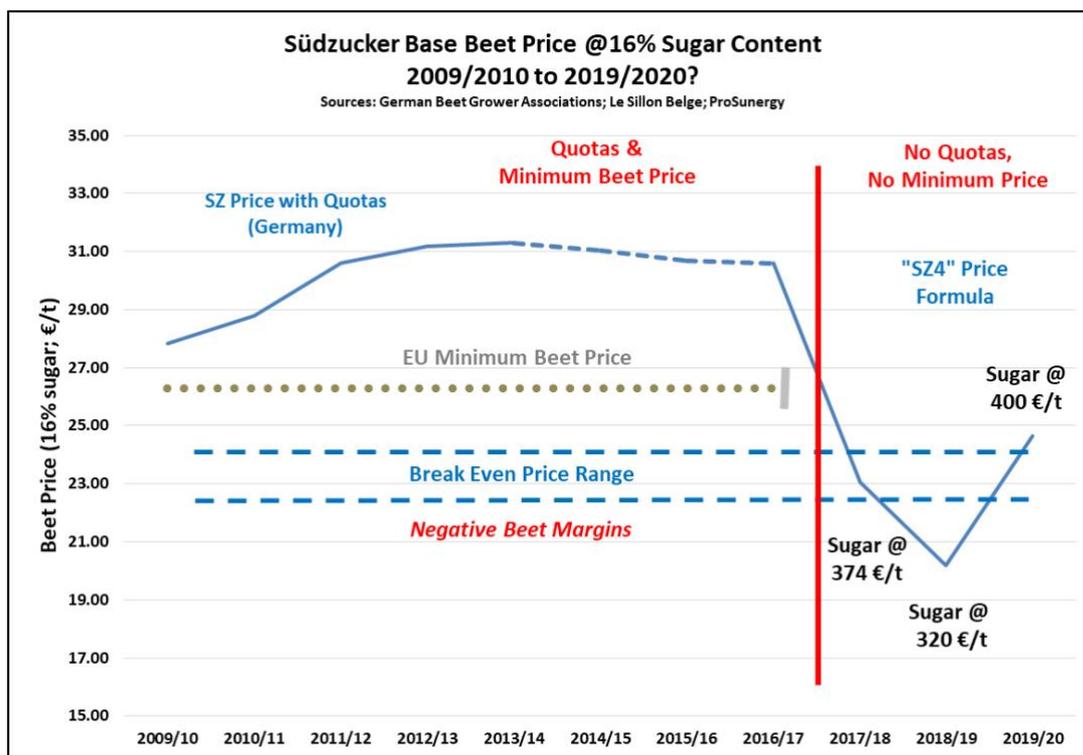
Beet-pricing formulas are considered sensitive and generally are unpublished. However, some elements have leaked into the media. For example, the Südzucker AG “SZ4” formula, which is applied in all of this processor’s 30 factories, can be estimated from grower publications. It gives the following results for the basic beet price, including pulp but excluding early, late delivery premiums/discounts, transport to mill costs, and dividends.



⁸ Frankfurt Stock Exchange; SZU Xetra.

Although formulas vary from processor to processor, this is the “new normal”. At first, cooperatives, which represent some 80% of EU processing, attempted to set “reference” or “pivot” beet prices but, faced with heavy losses, they have had to abandon any pretense of a minimum price for their feedstock.

The lessons one must learn from the new EU beet price-determination mechanism are two-fold: first, some years (probably few), growers will experience losses on their crop, and growers must now decide to plant depending on the expected margin on beets relative to expected margins of alternative crops, and the yield effects in crop rotation. In summary, the supply of sugarbeet has become volatile.



The second structural change for the industry is the need to minimize fixed costs.

In this capital-intensive industry, results are particularly price-sensitive. With this in mind and considering the new very direct link to world market price movements, processing fixed costs must be cut ferociously. For the biggest players with many factories, one solution is to close factories. It can be estimated that each closure saves some EUR 15 million (\$17 million) in annual fixed costs.

There currently are 107 sugar factories in the EU. The CEO of a major French cooperative that supplies 2.5 MMT of sugar annually in the EU said “10 to 20 sugar [EU] factories will close within 5 years, given that about one-fifth of the EU mills are not competitive.”^{9; 10} Nordzucker will close its refinery in Arlööv, north of Malmö, moving production to a nearby plant in Örtofta 20km away.

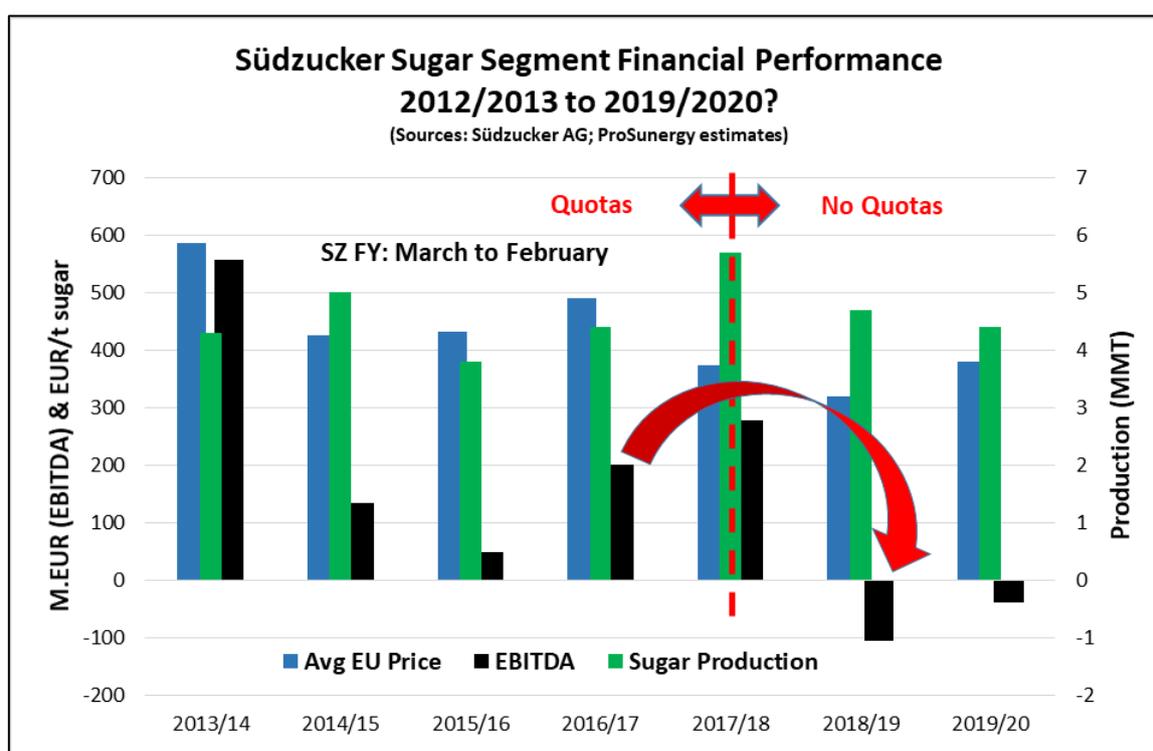
Südzucker AG has announced that it will close five of its factories, out of 30, for the 2020/21 campaign. These five sugar factories have an average annual total sugar production volume of about 700,000 tons.

⁹ CEO Alain Commissaire interviewed at the Dubai Sugar Conference, 17 February 2019.

¹⁰ Interestingly, some EU beet areas are so efficient that a project to build a new factory is being mooted. A “Coopérative de Seneffe” in Belgium has started initial studies and raised capital to start a 200,000 MT sugar factory in 2022.

Following the 2019/20 campaign, there should be two factory closures in Germany (Brottewitz and Warburg) and two factory closures in France (Cagny and Eppeville). The affected factory at the Polish subsidiary Südzucker Polska (Strzyżów) would be closed earlier. In addition, Südzucker plans to reduce administration costs in Belgium, Germany, France and Poland.¹¹

These savings should show up completely in the company's 2021/22 accounts. In the meantime, the financial consequences for Südzucker AG of the absence of quotas and world market price influence can be estimated hereunder:



As EU prices drop more than 20% between 2016/17, the last year with quotas, and a 2019/20 forecast of EUR 380/t (19.5 cents/lb), EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization; this is a measure of operational cash generation) is reduced by some 80%¹². Sugar company financial results are extremely sensitive to price and volume variations: if our 2019/20 sugar price hypothesis (19.5 cents/lb) increases 10%, Südzucker's EBITDA would nearly double.¹³ If Südzucker's sugar production for 2019/20 increases 10% over our forecast, EBITDA would again nearly double.

Reductions in slicing capacity by closing factories also help increase slicing time in the remaining factories, thus decreasing unit cost, and limit maximum production if the crop is unusually large.

Attempting to diversify and stabilize revenues and results, EU processors are showing renewed interest in investing overseas. Tereos, in Brazil, and British Sugar, in Africa, have been engaged in sugar production outside the EU for many years, but others have announced investments or enquiries. The German cooperative Nordzucker has just offered to buy three Mackay mills, in Australia, which process sugarcane.

¹¹ For Südzucker, "restructuring expenses could amount in total in the following years to EUR180 million to EUR220 million, of which about 70% are cash flow related."

¹² The 2015/16 record low EBITDA was due to the combination of a drop in production and low sugar prices when a minimum legal beet price was still in force.

¹³ Note that Goldman Sachs is far more pessimistic than ProSunergy about short term financial results.

The incentive to keep domestic supply below domestic demand drives a third structural adaptation.

A domestic deficit supports import-parity pricing. In this case, the price for imports needed to cover the deficit must include the cost of bringing sugar to the EU. If, in reverse, domestic supply is higher than demand, competitive pressure should tend to export-parity pricing. For refined sugar, the difference between import-parity and export-parity is easily 4.5 cents/lb: thus, the incentive for the EU industry to produce less than domestic demand is worth more than \$1 billion in revenues. EU sugar production should aim to reach just below domestic demand although effective production of course will fluctuate with weather conditions and, eventually, beet diseases.

EU competition law prevents the industry from organizing a desirable deficit. The next best solution has to be an uncoordinated, but rational, limitation of supply through capacity reductions. It serves nothing to be a large producer if every additional ton increases losses. That some initial factory closures concern competitive sugarbeet areas is significant: perversely, weaker EU competitors remain supported by direct EU subsidies allocated to unsustainable sugarbeets.

Because of low prices for refined sugar, stand-alone refining of raw sugar imports will survive only in areas far from competitive and surplus beet areas (essentially, the European Northwest), thanks to logistical barriers. Transporting sugar from surplus areas to deficit regions can cost up to EUR 100/t (5 cents/lb). Thus, stand-alone refineries importing raw sugar need to be located in the far south, or far southeast, of the EU. If the UK remains in the EU, the remaining UK refinery cannot survive because it is located in the most competitive sugarbeet region and one with a large surplus. In the future, EU refineries will generally process marginal volumes, which will vary depending on the size of the beet crop.

With domestic sugar prices in line with international prices, High Fructose Starch Syrups (HFSS), which in the EU are produced from wheat and corn are uncompetitive against sugar. In the run up to October 2017, HFSS capacity was expanded imprudently, probably by some 30 to 40%. Four new production units were built. In the event, demand for HFSS in the EU dropped from about 700,000 tons (equivalent sugar) before quotas were abolished to 550,000 tons¹⁴ today.

Not by Nature Alone: EU Sugar Industry Subsidies

As international market prices fell to 10-year lows and the EU produced a large domestic surplus, competition for internal customers increased. At best, domestic prices struggled not to fall from import-parity to export-parity. The link between domestic EU sugar prices and world market prices will endure, even if supply dips below demand. This situation is a deliberate consequence of the Common Agricultural Policy (CAP), which seeks to have commodity food prices as low as possible. The CAP also aims to offer consumers a stable supply of quality food.

Nonetheless, Europe's sugar industry remains imbedded in the CAP, which by law ensures that farmers have reasonable living standards and does so essentially through subsidies.

Common Agricultural Policy financial support for sugar comes under three guises: decoupled payments per hectare; coupled payments for sugarbeets in some Member States; and targeted area support for sugarcane in the Outermost regions, essentially for the French islands of La Réunion, Guadeloupe and Martinique.

Decoupled Payments

Whereas payments predicated upon the production of specific outputs indisputably influence supply, there is some uncertainty about the ultimate economic effects of decoupled payments. Not being

¹⁴ Before October 2017 and like sugar, HFSS was subject to a quota, which was set at 720,000 MT.

conditional upon the production of a given crop, they are deemed by the WTO to be minimally trade distorting. In the EU, they are justified by the need to provide proper living conditions to farmers, and by a growing list of “environmental services”. As a tool to provide income support, however, decoupled payments per hectare are a blunt instrument whose effectiveness in targeting poorer farming families is weak.

Direct decoupled payments represent about 70% of EU Common Agricultural Policy spending and some 10 to 11% of total EU farm income. Although slated to converge over time, decoupled payments vary by country and, sometimes, by region within a country. In France, for example, a large cereal and sugarbeet farm can expect its 2019 decoupled support income to be EUR 220 per hectare (\$100 per acre). But average EU decoupled support will be much lower, probably around EUR 165/hectare (\$75/acre).

For the 3.7 to 4.2 million acres of beet, 2019 direct decoupled payments can be estimated at about EUR 265 million (\$300 million). Should the EU’s direct decoupled payments for areas planted with sugarbeets be considered as support for its sugar industry?

Indisputably, such payments increase expected farm income and thus increase the value of the underlying farmland. In some EU member States, the expected support income stream can be sold to investors in exchange for a lump sum (which should represent the net present value of that income stream). In other words, direct decoupled payments increase the recipient farm’s financial resources. One could therefore argue that the support allows farms to price their production lower than would otherwise be the case, either because there will be less pressure to maximize income from market prices or because the recipient will use his wealth to improve productivity beyond what would be the case without the direct payments, or because of a combination of the two. While the exact effects of these decoupled supports on sugar production and price cannot be determined in advance, the fact remains that they provide a subsidy for every acre planted with sugarbeets.

Without decoupled payments, however, the price for farmland would drop (and so would farmland rental) and reduced revenue would push farms to improve economies of scale by merging. The spread of best practices would improve. In the EU, there is significant scope for such additional efficiencies. Without further investigation, it is impossible to determine whether these improvements would compensate for the disappearance of direct decoupled payments partially or totally.

Coupled Support

EU subsidies tied to the production of sugar come in two forms: Voluntary Coupled Support (VCS), which has a considerable impact on supply, and subsidies to maintain sugarcane in Outermost regions, which supports a small volume of sugar.

VCS was introduced in the last adjustments made to the 2014-2021 Common Agricultural Policy. VCS is intended to soften adaptations in regions of a Member State where “specific types of farming or specific agricultural sectors ... undergo certain difficulties”. “Agricultural sectors shall be considered as being in ‘difficulties’ if there is a risk of abandonment or of decline of production ...”.¹⁵ Member States independently choose whether to divert funds from their decoupled support allocations towards VCS up to a maximum of 13% of total support. In all, some EUR 4.5 billion (\$5.1 billion) are distributed through VCS annually. The largest beneficiaries of VCS are the dairy and meat sectors.

For sugarbeet, EUR 180 million (\$203 million) are thus distributed to growers in 11 Member States. This may seem a small amount, but its effects are material. With an average VCS subsidy of EUR 440 per hectare (\$201/acre), the EU sugar market is fundamentally distorted. Over some 1.05 million acres, 25% of the EU’s total beet area, the subsidy increases beet income by 20 to 25%. The consequence is

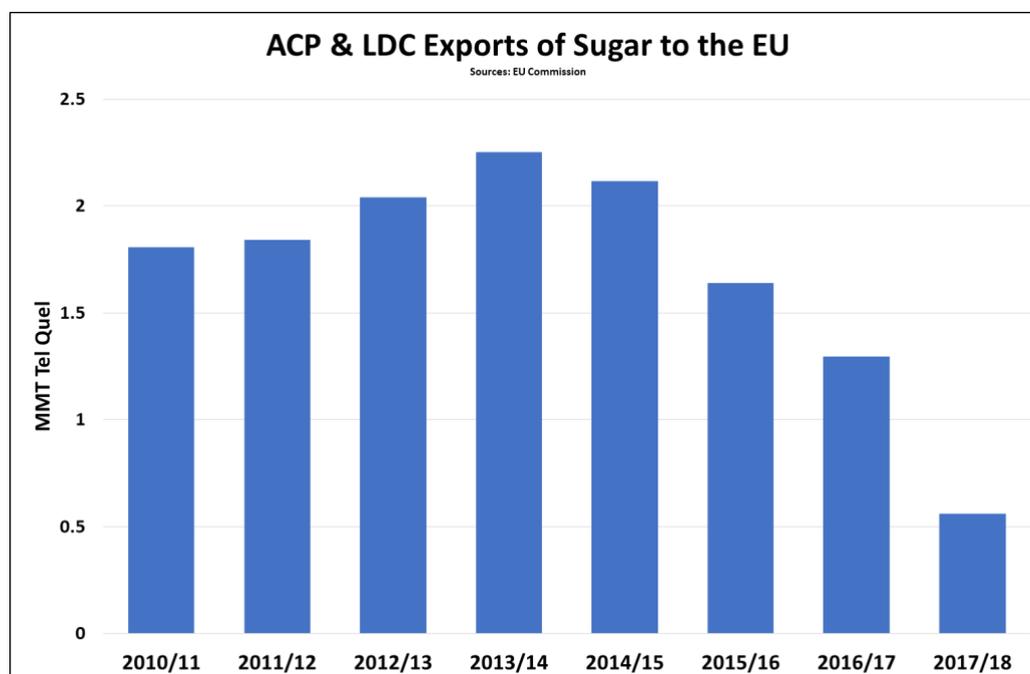
¹⁵ Chapter 1 of Title IV of Regulation (EU) No 1307/2013 and Delegated Regulation (EU) No 639/2014, article 52.3.

an increase in sugar output by an estimated 3 MMT annually. With domestic demand at 18 MMT, this is clearly significant.

EU sugar production supported by VCS from 2015/16 to 2017/18			
<i>Voluntary Coupled Support Subsidy for Sugarbeet</i>	2015/2016	2016/2017	2017/2018
	Actual	Actual & estimated	Forecast & estimated
Maximum area allowed (acres)	1,228,661	1,276,105	1,276,105
Area actually supported (acres)	942,338	943,102	1,052,369
Sugar produced (MMT)	3.2	3.9	4.1
Subsidy (M\$)	192	202	203

Sources: EU Commission; ProSunergy estimates

Because of VCS, over three years the EU has decreased its imports by 5.4 MMT and increased its exports by some 5.8 MMT. VCS thus harms the international sugar market. Another awful consequence of VCS has been the destruction of imports from poor countries which have duty-free quota-free access to the EU. In 2017/18, sugar shipments from African, Caribbean and Pacific countries (ACP) and Least Developed Country (LDC) origins were the lowest since records began.



By maintaining EU sugar production which otherwise would disappear, Voluntary Coupled Support decreases available EU market share for imports, lowers EU and international prices, threatens alternative international markets and contradicts EU efforts in favor of developing countries.

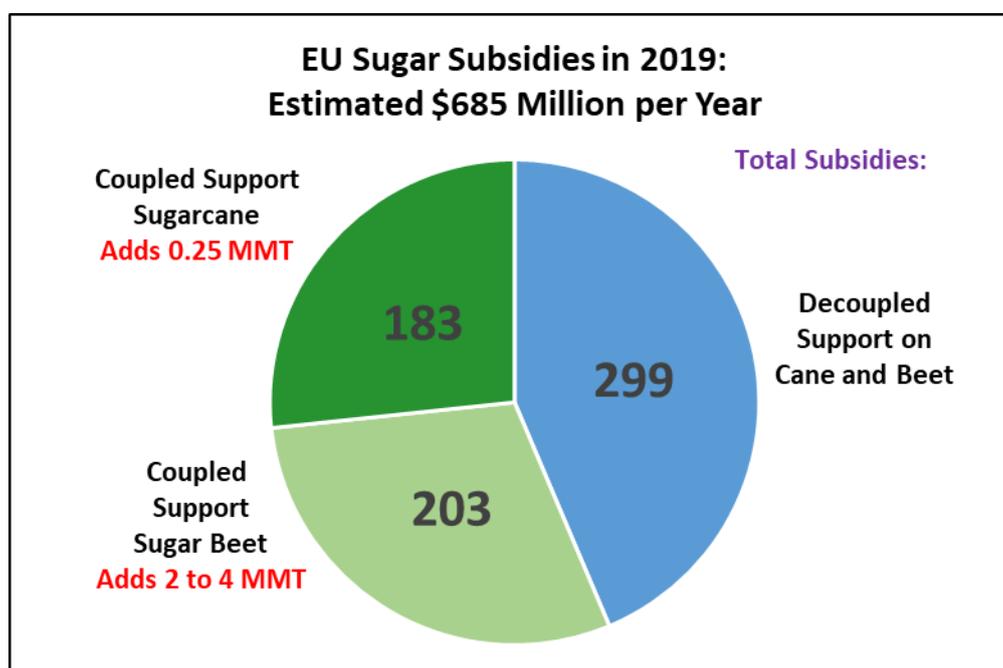
By boosting domestic supply, VCS also perversely increases the incentive to close factories, including efficient ones located in efficient beet areas, to better balance supply and demand. Public funds thus promote a less competitive EU sugar industry.

Beyond VCS, to maintain uneconomic but socially essential sugarcane in its Outermost regions, the European Union allows specific coupled subsidies for sugar in these territories. The French West Indies islands and La Réunion (Indian Ocean) together produce some 240,000 tons of sugar, and Spain's Azores islands (in the Atlantic, west of Portugal) another 800 tons of sugar. Of these overseas territories, La Réunion is the major supplier by far, with about 200,000 tons of sugar produced annually, and followed by La Guadeloupe in the Caribbean with about 40,000 tons.

Though the total volume involved is small, the economic and social importance of sugarcane to these small islands cannot be overestimated. Allowed annual support amounts to over EUR 165 million (\$182 million). This support, which is direct and coupled, represents 60 to 70% of a sugarcane grower's income. In La Réunion for example, aid per ton of sugarcane amounts to EUR 85 per metric ton (\$106 per short ton).

Without this support, the production of sugar in these small overseas territories would virtually disappear. With few, if any, alternative options to provide jobs, ending these subsidies would lead to deep social upheaval. In truth, Outermost region support should be properly viewed as a public security and solidarity expense.

In summary, the EU provides its sugar industry with about \$685 million in subsidies annually, or approximately 10% of sales.



Sources: EU Commission, French Ministry of Agriculture, ProSunergy estimates

Sugar in Brexit

“Brexit” is the name given to the United Kingdom leaving the European Union. When that happens, the EU will have 27 Member States instead of 28. It becomes the “EU27”. Post-Brexit EU sugar production will drop by about 1.3 MMT but consumption will fall by some 1.9 MMT: the UK runs a deficit in sugar. It will need to import up to 650,000 tons per year.

At the time of writing this report, both the timetable and the outcome of Brexit are undetermined. Politeness allows feelings to be expressed without precluding facts. With Brexit, British politics have ceased to be polite and have become detached from reality. In pursuit of independence from EU institutions and better immigration control, both reasonable if complex goals, three years after the referendum in which British voters decided to leave the EU, the United Kingdom has only begun to outline what policies to implement.

The UK and the EU27 have negotiated a Withdrawal Agreement. In effect, this is only a liquidation of accrued liabilities and allows continuity of relations in areas such as civil aviation. If the Withdrawal Agreement is implemented, a “transition period” of at least 18 months will apply during which the UK will continue to apply EU trade and agricultural policy rules in full. The British Parliament, however, is reluctant to ratify this agreement, so that in 2019 the UK may suddenly become an independent sugar producer and importer, with its own set of rules.

In preparation for “no-deal” – the failure to ratify the Withdrawal Agreement – Her Majesty’s Government has begun publishing draft trade rules and tariff schedules, and outlining a UK agricultural policy. It is also attempting to copy current EU preferential trade agreements, such as the Economic Partnership Agreements with ACP countries, for immediate implementation upon Brexit, to minimize trade disruption. These give an indication of how Great Britain would conduct its trade in sugar post-Brexit.

The UK depends on imports for 40% of its food requirements. It is probable that UK agricultural policy after Brexit will follow an EU template at first with, however, reduced subsidies and most imports gaining duty-free status, particularly for foods not produced in the UK.

For sugar, the UK intends to protect its domestic sugar market with a EUR 150/MT MFN import duty (7.7 cents/lb) for refined sugar, whilst retaining the EU’s current MFN tariff of EUR 339/MT (17.4 cents/lb) for raw sugar. The UK will implement a unilateral 0-duty preference for LDCs, Fiji, Caribbean countries of the CARIFORUM-EU Economic Partnership Agreement, and Eastern and Southern Africa Economic Partnership Agreement countries¹⁶. The British Government’s avowed aim is to rollover all EU preferential Free Trade Agreements and to share EU sugar Tariff Rate Quotas. An annual 260,000 MT “erga omnes” quota will also be created, presumably for raw sugar and with a tariff lower than the EUR 339/MT mentioned above. With this template, the UK would prevent EU27 sugar from being imported and, because of large duty-free preferential imports, probably have a domestic price some \$75 to \$150 per metric ton (3.8 to 6.9 cents/lb) above the world market price. Nonetheless, the precise contours of an independent UK sugar market are undetermined at this date.

The Common Agricultural Policy Going Forward

The next CAP will cover the period 2021-2027. It is being developed currently by the European Commission, the European Parliament and the European Council (of Member State governments)¹⁷. It will not change the rules presiding over the EU sugar market in any major way.

The two structural issues under discussion are the overall amount budgeted and how much flexibility will be given to Member States to allocate funds to local, not EU-wide, priorities (“subsidiarity”), sometimes with topping-up with national funds. A separate discussion concerns how much money should be allocated to environmental incentives, rather than to straight income support. The timetable

¹⁶ ESA members are Madagascar, Mauritius, Seychelles and Zimbabwe.

¹⁷ The Commission published its proposals in June 2018. Once Parliament and the Council decide on their amendments to the Commission’s draft CAP, negotiations to agree on a single version between the three institutions begin (the “Trilogue”).

for the adoption of the 2021-2027 CAP is tight, with a new Parliament and a new Commission beginning in September 2019¹⁸.

An obstacle to a quick agreement on the next CAP is the need for Member States to agree on the future EU budget. The current Multi-Annual Financial Framework (MFF) ends in 2020 and a new one must be agreed for 2021-2027. This is a seriously difficult enterprise, since Member State governments harbor diverging views on both the right overall amount and on how to spend it. Because some 35% of the total EU budget goes to the CAP, the overall size of the MFF is important¹⁹. Brexit adds a layer of uncertainty, with some Member States arguing for keeping current overall expenditure and others arguing for a reduction in step with the end of payments related to the United Kingdom. The Commission itself has made a proposal that, in effect, reduces agricultural expenses by about 10%, compensated in small part by allowing increased “co-financing” by Member States.

The CAP’s current and future economic aims are to have low food commodity prices and strong “branded” specialty foods. If needed, farmer support is ensured outside market forces through budgetary outlays set at a sustainable – or at least politically acceptable – fiscal level.

On the one hand, this gives European Union processing industries access to basic agricultural materials at the lowest possible prices (i.e. at, or close to, world market prices), makes them more competitive and tames domestic inflation. Indeed, since 2007 EU processed food exports have doubled to reach over EUR 140 billion in 2018. The EU is now the world’s largest exporter of food and drink products.

A direct consequence of linking domestic prices to world market levels is an increase in domestic price volatility. EU sugar offers a splendid example of this.

On the other hand, prices and sales of food specialties are promoted, notably through geographical indications of origin and artisanal production methods. Think “Prosciutto di Parma” ham or “Roquefort” cheese. In effect, EU uses Geographical Indications of Origin (“GIs”) as quality trademarks, limiting competition. There are over 3,400 EU GIs currently. EU data shows that geographical indication of origin products fetch prices which are, on average, 2.2 times above those of comparable “generic” products. Annual sales of EU GIs probably top \$63 billion.

In sugar, the main policy issues up for discussion in the next CAP are the future of Voluntary Coupled Support (VCS), and restrictions on access to effective plant-protection inputs and genetic engineering.

For the European Parliament’s Development Committee, the next Common Agricultural Policy should recognize that “coupled income support should not have negative effects on developing countries and should not create distortions of the internal and international market, which adversely impact on agro-food sector investment, production and processing development in partner developing countries.”²⁰ To meet this objective, the Committee proposes to exclude sugarbeets from the benefit of Voluntary Coupled Support. Unless either the European Parliament Development Committee’s views on VCS prevail or a WTO dispute settlement, or both, outlaw VCS, 2 to 4 MMT p.a. of unviable sugar will continue to distort the EU sugar industry.

Access to current or innovative modern agricultural genetic and phytosanitary tools is under threat in the EU. Public opinion is wary of “frankenfoods”, is rather sensitive to environmental issues and often believes that genetic engineering for agriculture necessarily damages “nature”.

¹⁸ European Parliament elections take place at the end of May 2019, so a new Commission (executive) will be chosen in the fourth quarter of 2019. That leaves precious little time to flesh out the next CAP.

¹⁹ 40% for agriculture may appear to be a very large proportion of public expenditure, but one should remember that the EU budget amounts to less than 2% of EU GDP. “Brussels” finances neither education, nor defence, nor public health. Those expenses are left for Member State to pay for.

²⁰ Proposed Development Committee amendment n°12 for recital 32 of the draft (CAP) regulation.

For example, the EU has now banned on the use of neonicotinoids for sugarbeet, arguing that these chemicals harm bees, although sugarbeet does not flower. The 2019 European sugarbeet crop would be the first in twenty-five years without the protection of seed treatments which were an effective defense against aphids carrying virus yellows - a disease capable of reducing yields by as much as 35 to 45%. There is no good alternative solution today. Using less efficient treatments would raise the cost of producing sugarbeet by more than \$4 per ton. Beyond a ban on neonicotinoids, there are threats on the use of herbicides, particularly glyphosate. Thus, usage of effective and safe environmental tools is being restricted. Their loss will damage sugarbeet competitiveness.

The EU establishes legal definitions, overall regulations, risk evaluation methods, authorization and prohibition procedures and labelling issues for Genetically Modified Organisms. Because of opposition to GMOs in a number of Member States, amongst which notably Germany and France, GMOs are undeveloped in the EU. Under EU law, farmers, or food and feed producers, who introduce a GM product in the supply chain or buy a GM product, must identify their supplier and to whom the products have been delivered. They must inform customers that the product contains, or is obtained from, GMO's. In the case of pre-packaged GM food (and feed) products, the list of ingredients on the label must indicate "genetically modified" or "produced from genetically modified [name of the organism]".

In practice, the combination of this compulsory labelling with the public's aversion to GMO's constitutes a material barrier to imports of GM sugar or of food products containing GM sugar. Commercially, GM food remains "a hard sell" in most EU countries and it will take time for this to change.

Applying current EU legislation, in July 2018 the European Court of Justice determined that mutagenesis techniques which appeared after the GMO law was enacted should be subject to that (rather restrictive) law. This decision has spurred a debate about changing the law to allow, for example, the CRISPER-Cas9 gene-editing technology. In January 2018 in a formal opinion, an advocate general in the European Court of Justice suggested relaxing the rules. A major confrontation between pro- and anti- mutagenesis processes will be played out in the medium term.

Political wariness of innovative agricultural tools, techniques and practices are serious headwinds, which will harm the competitiveness of EU sugar and spill over onto non-tariff barriers.

Indeed, extensive and often-misplaced application of the "precautionary principle" in EU law and politics hurts the Union's ability to compete against imports, which are, or would be, not subject to the same constraints. Limits or outright prohibitions on the use of genetically modified organisms, neonicotinoids, glyphosate, and other phytosanitary tools will disadvantage European farmers and food processors against imports, if the latter are not subject to similar restrictions.

Because of this, EU industries are pushing to enforce European production standards on imports. Non-tariff barriers to imports of sugar and sugar-containing products are likely to grow. Indeed, the European Parliament recently called for "an adjustment of the rules of international trade so as to allow the establishment of a common level playing field based on high standards... in accordance with existing EU social, economic, environmental, health, sanitary, phytosanitary and animal welfare standards"²¹.

EU rules designed to protect health, safety, consumers and the environment will multiply over time and will be imposed on imported goods increasingly, making it difficult for foreign suppliers to comply and gain access to European markets.

²¹ Resolution of 18 May 2018 - <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P8-TA-2018-0224&format=XML&language=EN>