

CHAPTER 6

TRADE LIBERALIZATION IN COTTON AND SUGAR

Impacts on developing countries

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INTRODUCTION

The past five years have seen a shift in the regulation of the international markets of agricultural products. For the first time since the settlement of the Agricultural Agreement of the Uruguay Round, agricultural policies of developed countries have been questioned in the World Trade Organization (WTO).

In 2002, Brazil, Australia and Thailand contested the European Communities' export subsidies on sugar. In the same year, Brazil contested the export credits and domestic subsidies provided by the U.S. government to its cotton producers. In both cases the reports of the Panel and the Appellate Body were in favour of the complainants.

Other developing countries reacted differently to these cases. The ACP countries were sceptical about the sugar case, which threatened to erode their preferential access to the European market. On the other hand, the cotton case was followed with high expectations by the West African cotton-exporting countries.

At the moment that this chapter was being concluded, the reform of the European Union sugar regime and of the United States cotton policies was still a subject of discussion. The EU approved the reform of its sugar policy in 2006 to meet the recommendations of the sugar panel, but it still has to be implemented. Because the new intervention prices remain higher than world prices, the EU will not be allowed to export more than its Uruguay Round commitment of 1.2 million tons per year. Any larger quantity will be taken as an indication that the cross-subsidization of exports due to the domestic subsidies has not been eliminated. This

makes it important to evaluate how the production and exports respond to implementation of the reform.

The US, for its part, has decided to partially implement the recommendations of the cotton panel. Export subsidies policies have been reformed – in the case of export guarantee programs – or eliminated – in the case of the so-called Step 2 subsidies. However, domestic subsidies that cause adverse effects on the international market have remained unchanged. One of the reasons for this is that reforming domestic policies for cotton would necessitate a reform of all commodity programs. The existing Farm Bill will be reviewed in 2007 and the U.S. government has decided not to pre-empt the debate.

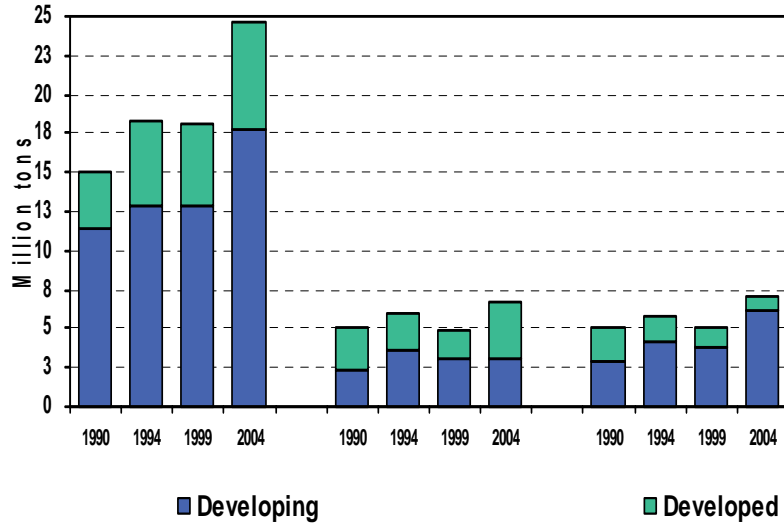
In addition to the panel recommendations, the multilateral negotiations of the Doha Round can also lead to the liberalization of the cotton and sugar markets. The 2001 Doha Mandate called for the elimination of export subsidies, significant reductions in domestic support, and substantial improvements in market access. In 2004, cotton was given a special status in the negotiations following a joint proposal by Benin, Burkina Faso, Chad and Mali that followed the same motivations as those of Brazil in the cotton case. Since the suspension in the negotiations in July 2006, however, the course of the WTO Doha Round has become uncertain.

This paper discusses the WTO process in sugar and cotton and its potential impact on different developing countries. The next section discusses the structure of the cotton and sugar world markets as well as the role of the developing countries in each of them. Section "*How developed countries' policies affect developing countries*" analyses how cotton and sugar world markets are distorted. This section focuses on the impact of developed countries' policies in the market. Section "*Liberalization of the world markets for cotton and sugar: impacts on developing countries*" is dedicated to discussing different elements of market liberalization: the forces both in favour of it and against it, scenarios taking into account the implementation of the WTO cases and Doha Round negotiations, and the balance between winners and losers. This section will also present a review of papers discussing the benefits of liberalization of the sugar and cotton markets. Section "*Final remarks*" contains concluding remarks.

INTERNATIONAL MARKETS OF COTTON AND SUGAR

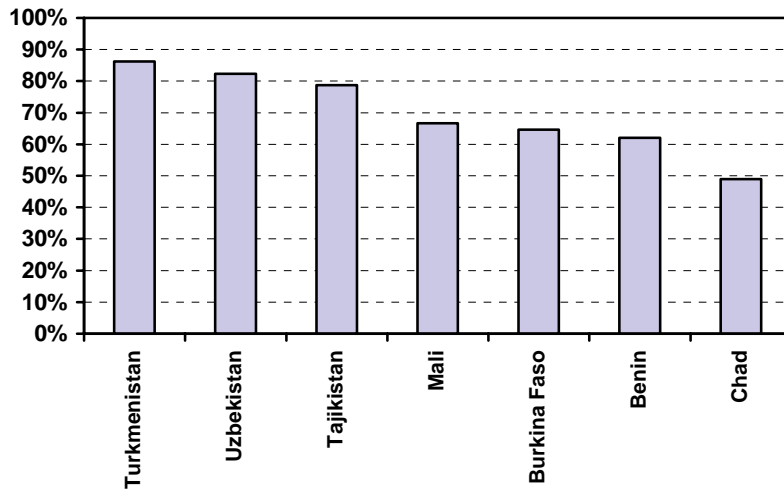
Cotton

Cotton is traded internationally in bales. Once harvested, the lint is separated from the seed (ginning process) before being sold to spinning mills. Although some spinners source cotton directly from ginning companies in exporting countries, the typical exportation transaction is performed by trading companies. Cotton lint is classified according to the quality of the fibre. The quality of the cotton is measured by staple length, strength, colour, uniformity, foreign matter and stickiness. These characteristics may vary depending on suppliers and crop year. The seed variety and the technology used for ginning are the main determinants of these characteristics.



Source: FAOSTAT (excluding intra-EU trade)

Figure 1. Production, exports and imports of cotton by developing countries and developed countries



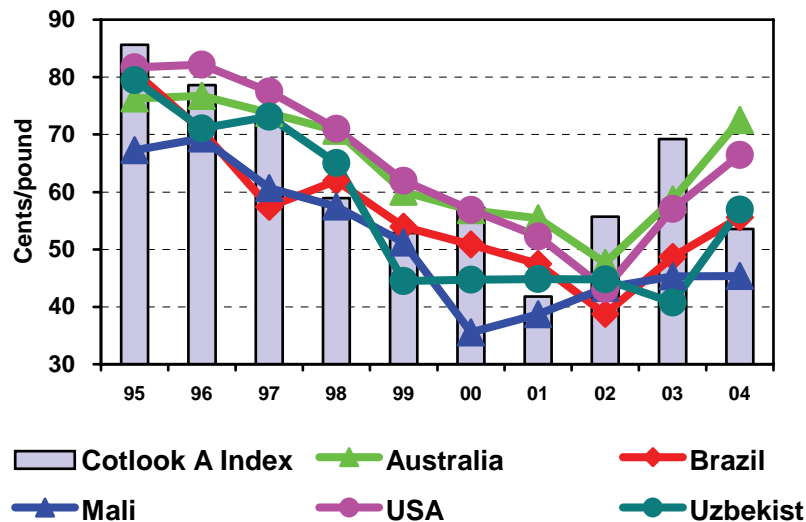
Source: FAOSTAT

Figure 2. Share of the cotton exports on total agricultural exports

Developing countries are responsible for the majority of the production and imports (Figure 1). The U.S. is the leading exporter, with 40 percent of world

exports. For some countries, cotton is the major export product. In Uzbekistan – the second-largest world exporter – 82% of total exports are concentrated in cotton. In Mali, Burkina Faso and Benin – three of the four countries that supported the sectoral initiative – cotton accounts for more than 60% of total agricultural exports (Figure 2).

World cotton prices fell between 1995 and 2002 (Figure 3) because of two major factors. One was the stabilization of world imports due to a reduction of import demand from China. The other was the expansion of U.S. exports, started in 1999. The American subsidies for cotton helped U.S. cotton producers to increase their production despite the non-dynamic world market. This exacerbated the international price fall and was the main motivation for the WTO cotton case and the African cotton initiative.



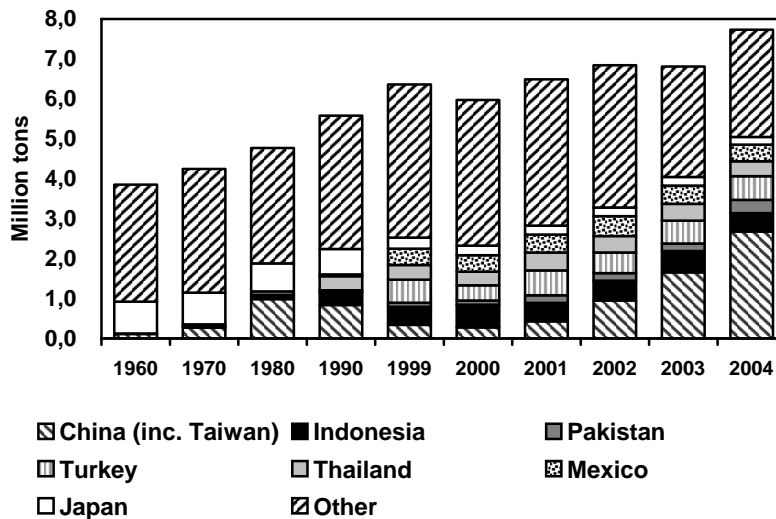
Source: ICAC, FAOSTAT

Figure 3. World price of cotton and export unit values

In the last four years, world cotton trade has shown a consistent growth. From 1.5 percent in the nineties, the average annual growth rate jumped to 5.3 percent from 2000. The main cause was the ending of the WTO Agreement on Textiles and Clothing in 2004. Companies started to make new investments, even some years before the agreement had officially ended, thereby stimulating new demand. China, after some years out of the market, started to import huge volumes in 2002. Imports also increased in Pakistan, Turkey, Thailand and several other developing countries. The demand from the Indian textile industry likewise increased, but imports decreased due to a recovery in domestic cotton production. On the other hand, in a

country like Mexico imports decreased as soon as its textile industry was no longer protected by the Textile Agreement (Figure 4).

Production in developing countries responded to the increased demand. From 2000 to 2004, their cotton production grew 5.6 percent a year. However, the performance of different countries varied substantially. Since 2002, the production of traditional cotton producers such as Turkey, Egypt and Uzbekistan has remained mostly constant despite the upturn in world production. Conversely, Brazil has appeared as a significant producer, while Sub-Saharan African production has grown 5 percent annually in the last five years. These countries, and some others like Paraguay and Egypt, are expanding their exports. Sub-Sahara Africa's export growth rate even reached 6.6 percent at one point. However, this region accounts for only 16 percent of world exports. However, by far the greatest increase in exports occurred not in developing countries but in the United States, where the combination of a rapid increase in production and decreasing demand from the U.S. textile industry resulted in a 76 percent increase in exports from 2000.



Source: ICAC

Figure 4. Main importers of cotton

Sugar

Sugar is traded internationally in raw and white forms. According to USDA data, raw sugar accounts for 56 percent of the world sugar market and white sugar for 44 percent¹. Raw sugar, which is traded in bulk, originates from sugar cane, a typical product of tropical areas. It is produced from the fermentation of the cane juice and the raw material for the refineries. Many countries import raw sugar and refine it domestically. Beet sugar is produced in temperate areas and is necessarily traded as

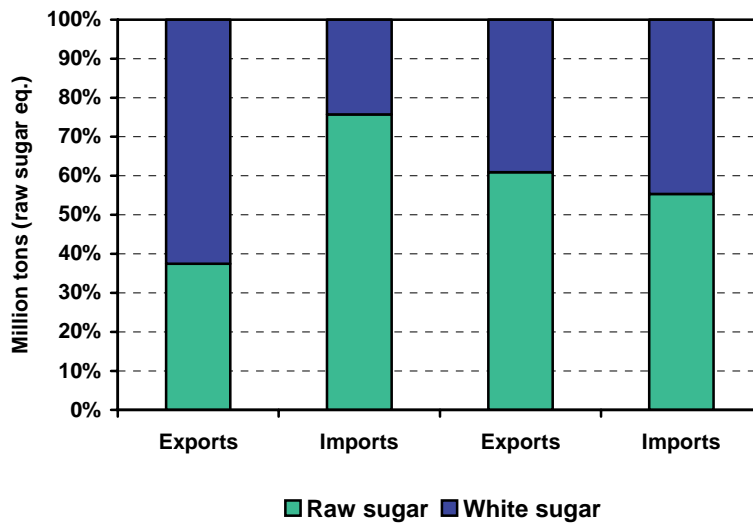
white sugar (in sacks). While sugarcane producers may export both raw and white sugar, beet sugar producers export only white sugar.

Because of climate conditions, most countries are specialized in either cane or beet sugar. While 73.5 percent of beet sugar is produced in developed countries, 91.4 percent of cane sugar is produced in developing countries. The United States is an exception, given that it cultivates as much beet sugar as cane sugar.

World production of sugar is around 142 million tons. Around 47 million tons per year is traded internationally². The ratio of trade to production has increased from 0.26 percent in the beginning of the 1990s to 0.33 in recent years.

Among the developed countries, the EU dominates the white sugar market. From the 7.1 million tons of developed country exports in 2004/05, the EU-25 exported around 6 million tons (86 percent). In the raw sugar market, Australia accounts for 99 percent of the total exports of developed countries.

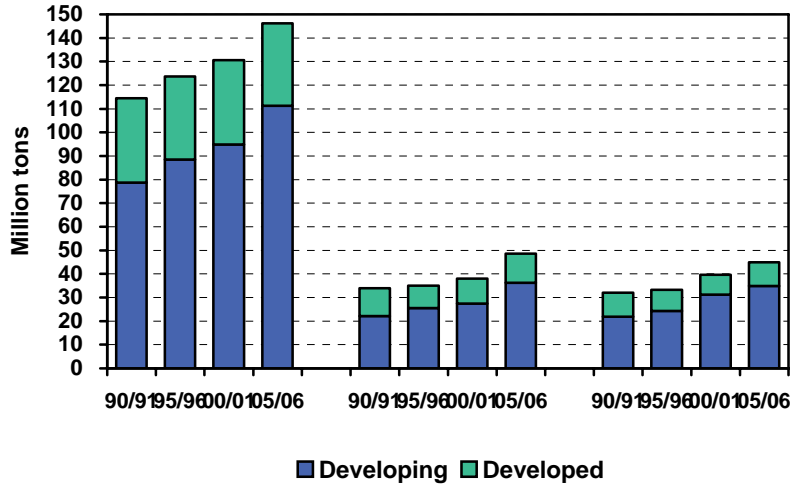
Developing countries sell 13.6 million tons of white sugar abroad (Figure 5). Brazil, Thailand, India, Colombia, South Africa, Saudi Arabia and the United Arab Emirates account for 70 percent of these exports³. The difference between developed countries and developing countries is still stronger in the raw sugar market, where developing countries export 22.8 million tons. Brazil, Thailand, Colombia, South Africa, Saudi Arabia, Guatemala and Cuba account for 81 percent of these exports.



Source: USDA/PSD

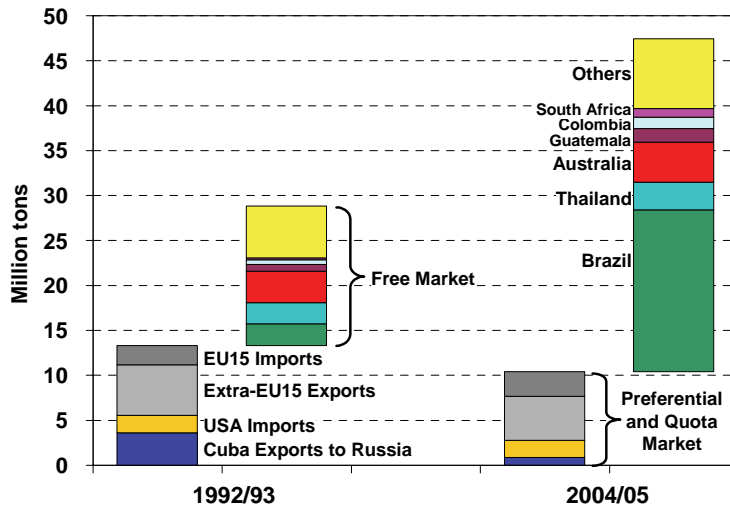
Figure 5. Trade of raw and white sugar: performance of developing and developed countries (2003)

Developing countries are also the most important importers. They import 35.3 million tons, compared with around 9.8 million tons imported by developed



Source: USDA/PSD

Figure 6. Production, exports and imports of sugar by developing and developed countries



Source: USDA/PSD; European Commission/COMEXT

Figure 7. Comparison between the free market and the regulated market of sugar

countries. While purchases by developed countries are concentrated in the raw sugar market (75 percent of their total imports), those of developing imports are more balanced between raw sugar (60 percent) and white sugar (40 percent).

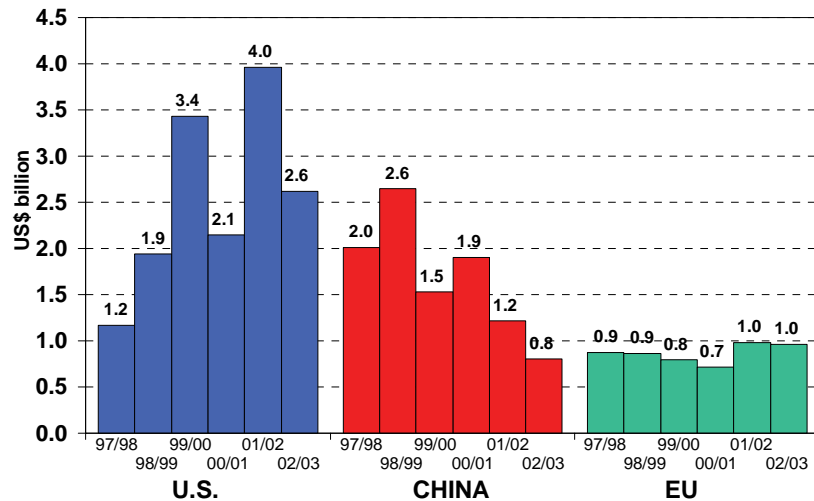
The historical data highlight two important facts. In the first place, developing countries are becoming more important in production, exports and imports (Figure 6) In the second place, with the growth of the volume traded internationally, the importance of the free market over the regulated (preferential and quota) market has increased (Figure 7)⁴.

HOW DEVELOPED COUNTRIES' POLICIES AFFECT DEVELOPING COUNTRIES

Cotton

Although import restrictions are less important in cotton, the world cotton market is strongly distorted by price-based payments and export competition policies (ICAC 2002; FAO 2004). The three countries that give most support to their cotton producers are the U.S., the EU and China (Figure 8).

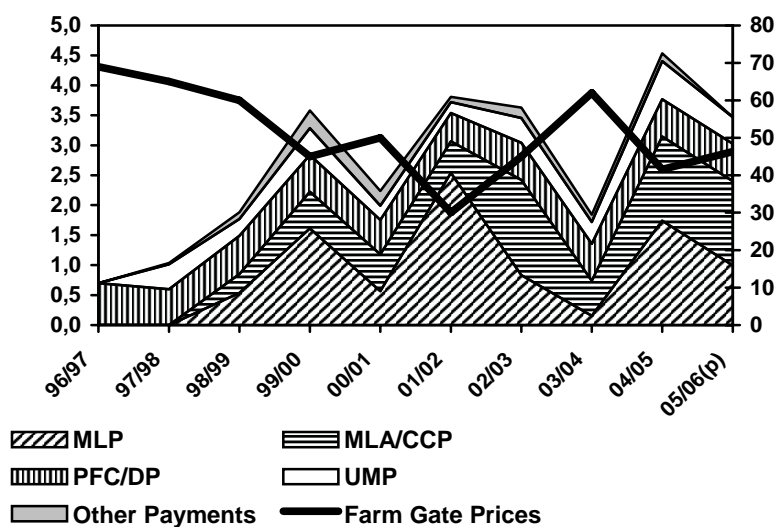
The cotton program of the European Union keeps its net imports lower than they otherwise would be (Karagiannis 2004). Cotton producers are supported by guaranteed prices and direct payments. The aggregate support level is determined by the difference between the indicative (guaranteed) price (€1,063/ton) and the world price as well as the proportion of production to the maximum guaranteed quantity (782,000 tons for Greece and 249,000 tons for Spain). An excess of production over



Source: ICAC, USDA, European Commission

Figure 8. Amount of support given by the governments to the cotton farmers

this quantity leads to a discount on the indicative price so that the total amount of support is reduced. The discount has been consistently higher in Greece than in Spain because the surplus of production in the former was higher. Chinese cotton production has been traditionally supported by price supports and subsidies for transportation, marketing and public stockholding. However, reform in 1999 reduced the level of support. Besides, China's accession to the WTO resulted in a reduction in government intervention, and a further adjustment of policies to WTO rules is to follow. China has a tariff rate quota of 894,000 tons on which it imposes a one-percent tariff against an over-quota tariff of 40 percent. Since 2003, the quota volume has been extended to meet increasing domestic demand requirements. To sustain domestic prices, a state trade enterprise operates one-third of total imports. In the future, China will probably shift to direct payments to producers.



The following programs are included in the chart:

1. MLP (Marketing Loan Programs): LDP (Loan Deficiency Payments), MAL (Marketing Assistance Loans) and CEG (Certificate Exchange Gains).
2. MLA (Marketing Loan Assistance) and CCP (Certificate Exchange Gains).
3. Decoupled payments: PFC (Production Flexibility Contracts) and DP (Direct Payments).
4. UMP (User Marketing Payments – Step 2).
5. Other Payments: CSP (Cotton Seed Payments), Storage payments and Commodity Loan Interest Subsidy and Fees/Levies.

Source: USDA-CCC & WTO. Elaboration: ICONE

Figure 9. US: Domestic support to cotton

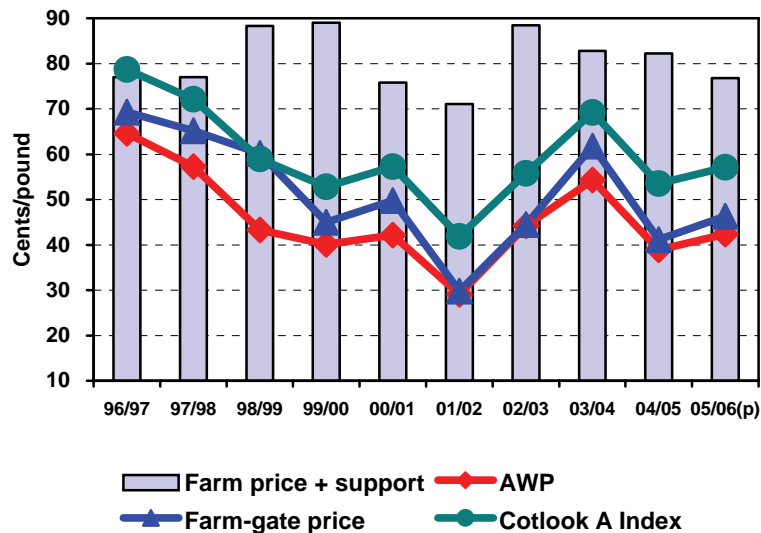
It should be noted that the cotton policies of the EU and China have limited distortive effects. The EU is not a major player in the world market, while China's cotton policy has become less distortive since this country has reduced its cotton support and increased its imports. The world cotton market is mainly affected by U.S. policies. U.S. cotton programs shield cotton producers against price

fluctuations and support producer revenue in ways that have a significant negative effect on world prices (Gillson et al. 2004; Goreux 2004).

According to the USDA, the U.S. government transferred US\$ 4.5 billion in 2004/05 to its cotton producers, in other words US\$ 180,000 per farmer. Cotton farmers receive subsidies from different programs (Figure 9). Marketing Loan Programs (MLP) are tied to production and inversely related to world prices⁵. As a consequence, they strongly affect production decisions made by cotton farmers.

Counter-cyclical payments (CCPs) are likewise related to world prices, but tied to fixed past production⁶. They were created by the 2002 Farm Bill to replace the Marketing Loss Assistance (MLA) that was introduced as an emergency measure when the programs of the 1996 Farm Bill proved unable to prevent strong decreases in farm income in the period of low prices between 1998 and 2002. The institutionalisation of this assistance in the form of the CCPs is a clear indication that U.S. cotton farmers are becoming more dependent on government transfers. CCPs affect producers' decisions because they reduce price risks, and because the 2002 Farm Bill has allowed producers to update the base acreage on which these payments are based.

Something similar is true for the direct payments (DPs), which are linked to the CCP base acreage. Although they are not tied to current production and prices, they represent an additional income support, even in periods of high prices.



Source: USDA-CCC & WTO. Elaboration: ICONE

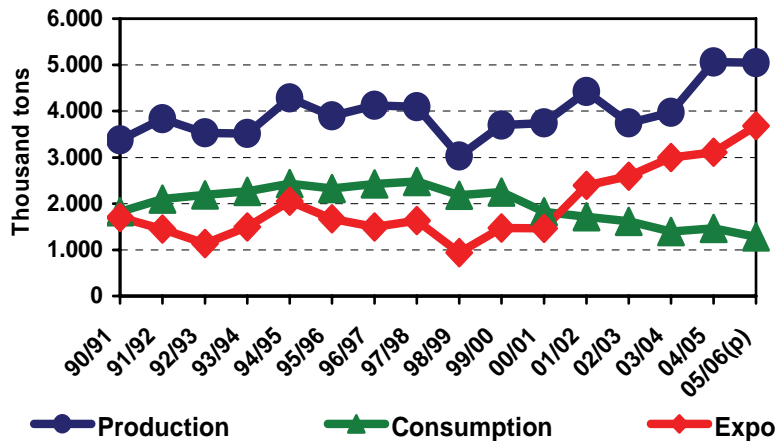
Figure 10. Comparison between the prices received by US farmers and the world prices

In addition to these payments, which are directly or indirectly linked to production, the 1996 FAIR Act also introduced another support instrument for the

cotton sector that was more specifically linked to exports. This was the User Marketing Payment (UMP) or Step 2 payment⁷. This payment is notified under the Amber Box. Expenditures on it reached their peak in 1999 (US\$446 millions).

The recent evolution of U.S. production and exports of cotton clearly exhibits the influence of these various support measures (Baffes 2003; 2004). Although domestic demand was decreasing, production continued to grow rapidly, even in the period of falling international prices. Evidently, the support measures eliminated the incentives for farmers to adjust their production to the new conditions in the domestic and international markets.

Also, there is a strong relation between the evolution of U.S. exports of cotton and the low prices between 1998/99 and 2001/02. While Sub-Saharan African exports stopped growing, and Uzbekistan exports decreased during these years, U.S. exports recovered quickly (Watkins 2002). Figure 10 shows that the actual price decrease (farm-gate price plus government payments) was less sharp for the U.S. cotton farmers. In 2001/02, when international prices were at their lowest levels, U.S. farmers decided to plant more cotton (Figure 11). The peak of U.S. production in that year coincided with the peak of transfers from the U.S. government to cotton farmers.



Source: USDA/PSD

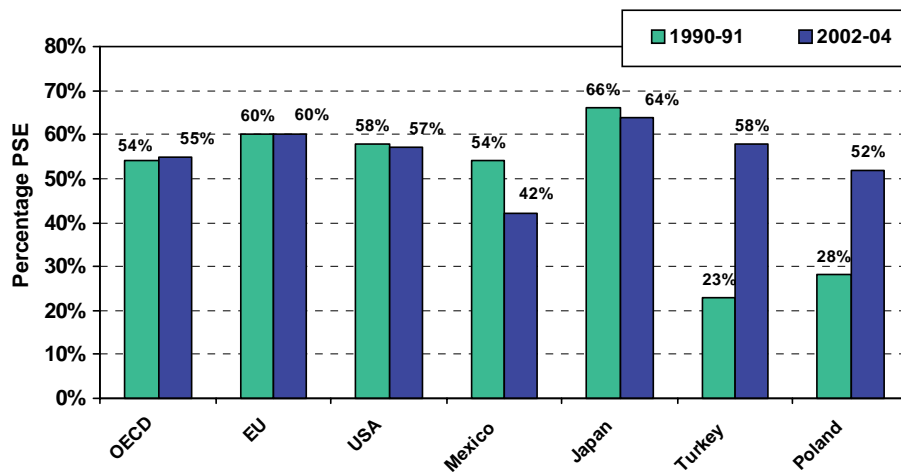
Figure 11. U.S. cotton supply and demand

The final report of the cotton panel found that the user marketing payments, together with the export credits programs (GSM-102, GSM-103 and SCGP), should be considered export subsidies. Given that the U.S. had no export subsidy commitments for cotton, they were illegal and should be eliminated or reformed in order to eliminate the export subsidy component. In August 2006, the UMP was repealed and the export guarantee programs have been reformed in line with the panel’s recommendations⁸.

The panel report considered the DPs non trade-distorting. However, it found them product-specific and therefore not notifiable as a green box provision. As for the MLPs and CCPs, the report found that these subsidies could cause price depression and serious disadvantages for cotton exporters. The U.S. should therefore modify these programs in order to eliminate their price-distorting effects. As yet, no modification to the provisions of these programs has been made by the U.S. government. However, the panel results are strongly influencing the negotiations for the new farm bill⁹.

Sugar

The world sugar market is being distorted by trade barriers and export subsidies (Dymock 2002), which keep domestic prices in important OECD countries at high levels (Figure 12). According to the CIE (2002), domestic sugar prices in the U.S., the EU and Japan are 153 percent, 211 percent and 383 percent of international prices, respectively.



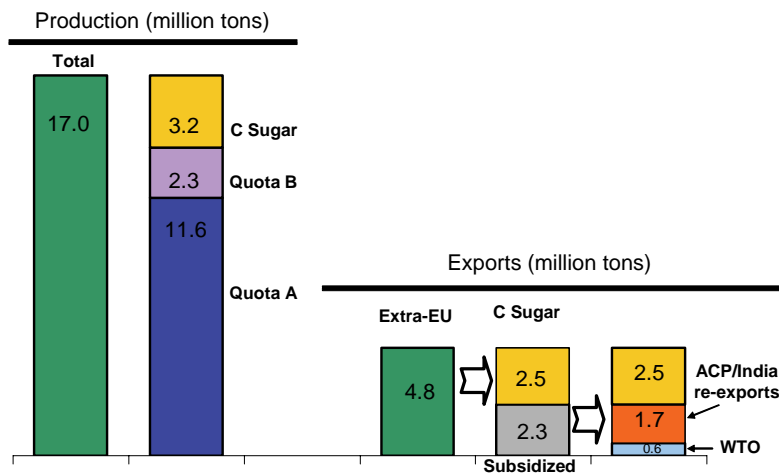
Source: OECD

Figure 12. Sugar producer support estimate (PSE as ratio of gross farm receipts)

Japan and the U.S. are net importers of sugar and use border mechanisms to protect domestic production. The U.S. has three WTO tariff rate quotas and one quota for the intra-NAFTA trade. Quota volumes are allocated to exporting countries according to the export performance in the period from 1975 to 1981¹⁰. Over-quota imports are prevented through prohibitive tariffs and entry prices. The domestic market is regulated by minimum prices. If domestic market prices fall below these, sugar producers are allowed to sell their production to the USDA. Japan supports its sugar industry by importing raw sugar at international prices and reselling it domestically at higher prices. Thus the domestic prices are kept above

the minimum prices set by the government. A semi-governmental monopoly (Agriculture and Livestock Industries Corporation – ALIC) manages the internal market and sets the domestic prices. Both the U.S. and Japan distort the market, not by subsidizing exports but by importing less than they would if their markets had been open.

The EU sugar policy is much more complex. Like the U.S. and Japan, the EU imposes high border protection. Prohibitive over-quota tariffs (€19.0 per ton for white sugar and €39.0 for raw sugar) and additional duties under a special safeguard clause that are to be applied when the representative price falls below a trigger price, prevent any out-of-quota imports. However, the EU also has a surplus of sugar, which is exported with export subsidies. Moreover, the EU has an additional problem to manage: the imports of sugar coming from various categories of countries to which it has provided preferential access. The EU sugar policy implements a whole range of instruments, including production quotas, intervention prices, minimum prices for sugar beet, tariff rate quotas, prohibitive over-quota tariffs, and export refunds.



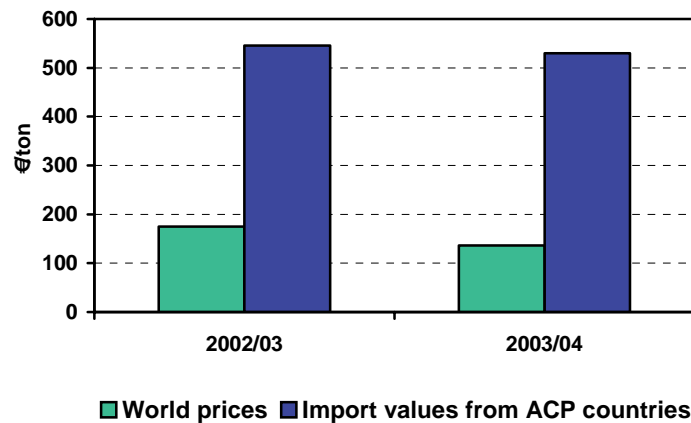
Source: EC/DGA

Figure 13. Structure of production and exports of sugar in the EU-15 (2004/05)

Figure 13 explains the situation under the EU sugar regime in 2004/05, before the reform of 2006. Domestic production equalled 17.0 million tons. Of this, 11.6 million tons fell under the A quota and was intended for domestic consumption. An intervention price of €632 per ton established a price floor for this sugar. Another 2.3 million tons fell under the B quota. It was eligible for the intervention mechanism but subject to a levy of maximally 30 percent of the price. This levy was (and is) used to export 1.2 million tons of this B sugar (the maximum to which the EU has committed itself in the WTO) with an export refund. In addition, the EU had

two other kinds of sugar exports. It was these that were challenged by Brazil, Australia and Thailand in the sugar panel. The first was the over-quota production, called C sugar, which was exported without an export refund. In 2004/05, the EU produced 3.2 million tons of C sugar, exporting 2.5 million tons and carrying over 0.6 million tons to the following crop year. The panel found that the subsidies granted to A and B sugar had spill-over effects on C sugar, which was in this sense also exported with export subsidies (Watkins 2002; 2004).

In the second place, the EU exported a volume equivalent to the 1.7 million tons of white-sugar equivalents that it imported free of tariffs from countries to which it provided preferential access. The EU has established five different types of such preferences: the ACP Protocol and India Agreement, with a tariff rate quota of 1.3 million tons; the OCT quota for EU overseas countries and territories; the tiny CXL quota (82,000 tons from Brazil and Cuba); the 'Balkans' initiative (free access for Albania, Bosnia-Herzegovina, Croatia, FYROM and Serbia and Montenegro); and the Everything-but-Arms initiative through which LDCs are to gain gradually free access¹¹. The preferential imports from ACP countries are highly concentrated in a few suppliers. Of the 1.3 millions tons imported under the ACP protocol and the India Agreement, 68 percent came from Mauritius, the Fiji Islands, Jamaica and Swaziland, none of which are LDCs. On the other hand, important poor sugar-producing countries such as Ethiopia, Mozambique, Sudan, Zimbabwe and Malawi have no quotas or quotas that are very small compared to their export potential. The subsidized export by the EU of a volume of sugar equivalent to that imported under these various preferential agreements was the other modality that was challenged by Brazil, Australia and Thailand, and condemned by the sugar panel.



Source: EC/DGA; NY Board of Trade

Figure 14. World sugar prices and EU import values from ACP countries

As a response to the panel's verdict, the EU approved an effective reform of its sugar regime in 2006¹². Intervention prices for white sugar and minimum prices for

sugar beet were reduced and the difference between A and B sugar eliminated; temporary financial assistance was offered to beet and sugar producers in countries that would reduce their quota production by more than 50 percent; and domestic surpluses were to be managed by subsidies for private storage, intervention purchases, and stimulating of non-traditional uses like bio-ethanol. It is expected that sugar producers will opt for receiving the financial assistance as they will not be able to produce cost-effectively under the new domestic prices. As a consequence, production will be reduced even though the production quotas themselves remain unchanged.

Although the sugar reform does not result in significant changes in the provisions for imports, the reduction in domestic prices will decrease the prices received by preferential suppliers. This, in turn, will reduce distortions in the world market because the prices paid for preferential imports were much higher than the free world-market prices (Figure 12). Nevertheless, the costs of this preference erosion for least developed countries are burdensome.

LIBERALIZATION OF THE WORLD MARKETS FOR COTTON AND SUGAR: IMPACTS ON DEVELOPING COUNTRIES

The previous sections described the world markets for cotton and sugar and the developed country policies that have distorted these markets. This section will discuss the impacts that trade liberalization will have on developing countries. In doing so, the cases of cotton and sugar should be analysed separately. For cotton, all exporting developing countries will benefit from liberalization. For sugar, however, the outcome is more complex.

Developing countries that benefit from preferential exports will see their preferences being eroded and their export prices reduced, but competitive developing countries will expand their exports and receive higher prices (Wohlgenant 1999; Van der Mensbrugge et al. 2003).

In both cases, it is essential to define the liberalization scenario precisely, given that it will be a combination of reductions in trade barriers, domestic support, and export subsidies. At the time of writing, there were two main drivers of liberalization: (i) the decisions of the cotton and sugar panels; and (ii) the Doha Round negotiations. (Table 1 summarizes the forces in favour of, or against, the liberalization of the cotton and sugar markets.) For cotton, the implementation of the panel's decisions would lead to a significant adjustment of U.S. policies. Additionally, a successful completion of the Doha Round would add a reduction in the EU subsidies and an increased access to the Chinese market. For sugar, the implementation of the panel's decisions means the elimination of EU export subsidies granted to the exports of ACP/India equivalent sugar and the implicit export subsidies for C sugar. In addition, a successful Doha Round would open, even if only partially, the protected domestic markets of the EU, the U.S. and Japan.

Liberalization in cotton

The main findings of the cotton panel were that:

- (i) the direct payments (DP) were not green box measures and should be subject to limits and commitments of AMS;
- (ii) the export credit programs (GSM 102, GSM 103 and SCGP) and the UMP (step-2 payments) were export subsidies and should be eliminated since they are inconsistent with U.S. export subsidy commitments;
- (iii) step-2 payments, marketing loan programs, production flexibility payments, direct payments, marketing loss assistance, counter-cyclical payments, crop insurance payments and cottonseed payments granted domestic support on a commodity-specific basis;
- (iv) marketing-loan programs, step-2 payments, marketing loss assistance and counter-cyclical payments caused significant price suppression, and their adverse effects in the world market should be eliminated.

Table 1. Forces working for or against the liberalization of cotton and sugar markets

	For	Against
Cotton	<ul style="list-style-type: none"> – Cotton panel: (i) eliminate export payments (Step-2 and export credit programs); (i) eliminate adverse effects of domestic support payments (MLP and CCP) – Doha Round: reduce trade-distorting domestic support – Sectoral initiative required by African countries demanding trade liberalization – U.S. domestic conditions: claims from agricultural sectors that receive small amounts of subsidies compared to ‘grains’ (including cotton) sectors 	<ul style="list-style-type: none"> – U.S. domestic conditions: (i) cotton farmers’ lobby; (ii) negotiations on 2007 Farm Bill; (iii) dominance of the legislative over the executive in the formulation of farm programs. – Restricted capacity of the WTO Dispute Settlement Body (DSB) to enforce panel recommendations
Sugar	<ul style="list-style-type: none"> – Sugar panel: (i) eliminate subsidies provided to exports of ‘ACP/India equivalent sugar’; (ii) eliminate cross-subsidization of C sugar exports – Doha Round: (i) phase out all export subsidies; (ii) increase market access through tariff reduction and TRQ expansion 	<ul style="list-style-type: none"> – EU domestic conditions: difficulties for the European Commission to implement a reform that will result in effective elimination of subsidized exports – ACP countries: revenue loss due to reduction of EU intervention price – Doha Round: preference erosion due to tariff reduction

The U.S. can choose between some alternative ways of implementing the panel’s decisions. From the point of view of developing countries, the most desirable one is close to liberalization of the market. In this case, export payments and distorting

effects of price-based subsidies would be eliminated, even if other domestic subsidies would not be. Once price-based subsidies have been eliminated, U.S. farmers will respond to market signals rather than government payments in taking their production decisions. As a consequence, U.S. production will be adjusted to an extent depending on the level of world prices (Poonyth et al. 2004; Sumner 2003).

Analysts of the impacts of cotton trade liberalization agree that domestic and export subsidies are the main reason for the market distortions; that liberalization would mainly lead to adjustment in production in the U.S. and the EU; and that the removal of developed-country subsidies would result in higher world market prices¹³. Nevertheless, the question of access to the Chinese market cannot be neglected. Since 2002, China has become the world's largest importer of cotton. At present, its imports even exceed its tariff rate quota. A successful WTO round would stimulate more access to the Chinese market through over-quota tariff reduction and TRQ expansion. Nevertheless, elimination of trade distorting support by the US is needed to ensure that China's increased imports will benefit developing countries and improve world-market prices rather than leading to new increases in US production.

Liberalization in sugar

Where sugar liberalization is concerned not all developing countries would gain by trade liberalization (Elbehri et al. 2000). Certainly, least developed countries will face preference erosion and revenue losses due to the reform of the EU sugar regime. The balance between winning and losing developing countries depends on how sugar liberalization is approached. One approach, which is central in the sugar case against the EU, is to eliminate export subsidization. Another approach, which is central in the Doha Round negotiations, is the elimination or reduction of trade barriers.

The main findings of the sugar panel were that:

- (i) the export refunds granted to the export of ACP/India equivalent sugar violated the EU export subsidy commitments;
- (ii) the EU sugar regime led to the cross-subsidization of the export of C sugar, which likewise violated the export subsidy commitments of the EU;
- (iii) the EU was recommended to bring its regulations into line with its obligations with respect to export subsidies.

The main implication of this recommendation is that the EU is constrained by the quantity (1,273,500 tons) and value (€499.1 million) of its current WTO commitment regarding subsidized sugar export. Any export beyond that level involves export subsidies. Of the 5.3 million tons of white sugar exported in 2003/04, 1.1 million tons were exported with regular export subsidies and 4.2 million tons with subsidies that should be eliminated. Given that the guaranteed sugar price in the EU is far above the international price, the EU can only manage its excess supply by reducing its domestic production. The phasing out of the EU's subsidized exports will benefit all sugar exporting countries, mainly the developing ones which account for almost 80 percent of world exports.

Reforming the EU sugar regime was a necessary condition for eliminating subsidized exports without changing the market access granted under trade preferences (Mitchell 2004). Reforming it through the reduction of guaranteed prices was an option that has transferred the burden of adjustment to domestic producers but also to preferential partners. Even though the latter have not lost market access, their export revenues have decreased. On the other hand, the reform will lead to a more balanced distribution of preferential trade shares across the EU's partners, thereby rewarding the most competitive sugar producers. In that sense, the reform goes in the right direction because it tackles two distortions: non-competitive subsidized exports and sugar imports under preferences from a few countries that are privileged compared to all ACP countries.

A more far-reaching liberalization of sugar trade might be achieved by the reduction of trade barriers as an outcome of the WTO Doha Round. Many studies have shown that reduction or elimination of trade barriers will lead to a rise in world prices and a reduction of price volatility. Different liberalization scenarios show that the developing countries will capture the benefits in terms of export volumes and welfare gains, and that the U.S., the EU and Japan will see an increase in their imports and a reduction in their production.

The distribution of gains among developing countries will depend on how far-reaching the liberalization will be. Multilateral liberalization will mainly benefit the most competitive developing countries. Partial liberalization, such as quota expansion on a non-MFN basis, will mostly benefit the countries with preferential access. A combination of this with over-quota tariff reduction can lead to a more balanced distribution of gains among countries with and without preferential access. A comparison of different scenarios by van der Mensbrugge et al. (2003) shows that both under a partial and a full liberalization, most of the gains go to developing countries, and all developing countries will benefit. Even in the full-liberalization scenario, the gains will be fairly distributed across developing countries, although the most competitive among them will benefit more.

The main concern related to any liberalization scenario is the problem of preference erosion. However, even among developing countries with preferential access in the U.S. and the EU, this issue is controversial. Many competitive African and Central-American sugar producers wish to have increased access to U.S. and European markets, and are unhappy with the fact that the allocation of the import quotas over countries is constraining their export volumes. For these countries, preference erosion is not a major concern.

Conversely, preference erosion is a real problem for some developing countries that are highly dependent on U.S. and EU imports. Countries that can only export for high prices and face a prospect of preference should be compensated by the U.S. and the EU. The most competitive agricultural developing countries such as Mercosur members Chile, Mexico and Colombia should contribute by offering duty-free and quota-free access to least developed countries.

FINAL REMARKS

Both for cotton and sugar, developing countries are the largest producers and exporters and face unfair competition from subsidized exports and closed markets of many developed countries. In addition, developing countries are also the largest importers of these products, meaning that their markets are more open and their policies less trade-distorting than those of developed countries. Trade liberalization, therefore, first of all means the reform of developed countries' policies. This will benefit producers and exporters in developing countries. In the short run, they will benefit from a rise in prices and, in the long run, from new market opportunities that will be opened as developed countries withdraw subsidized exports and provide more access to their domestic markets.

The hard nut to crack in all this will be enforcing reform on developed countries' policies. The cotton and sugar cases and the agricultural negotiations in the Doha Round are the two vectors of change. Both will have a positive influence but the final outcome is still uncertain.

For cotton, both the panel's recommendations and the WTO negotiations may entail a reduction in the distorting effects of U.S. policies. Implementation of the panel's recommendations will involve the elimination of exporting payments through the reform of the export credit programs and the removal of step-2 payments. However, reducing the price suppression effects of price-based payments will depend on new farm policy legislation. The debates on the 2007 farm bill have already started in the U.S. and their outcome will be directly related to the reduction in domestic support on which parties will agree in the Doha Round. If a considerable reduction in domestic support is agreed upon, the U.S. administration will be obliged to negotiate a more far-reaching reform of the farm bill with the Congress. If the WTO negotiations lose ambition in this respect, the U.S. will be encouraged to keep its farm programs largely unchanged.

In the case of sugar, the WTO case has accelerated the reform of the EU sugar regime that the European Commission has already been trying to introduce since the early 1990s. Before the conclusion of the WTO case, the Commission mainly aimed at the elimination of the export refunds. The sugar panel's recommendation has obliged the EU to implement a broader reform because the cross-subsidization of C-sugar exports must also be ended.

By reforming its sugar regime, the EU will be prepared to implement a number of possible results of the Doha Round negotiations: (i) phasing out export subsidies; (ii) reducing import tariffs (at least the 'water in the tariffs') without exposing its domestic market to the international market; and (iii) reducing domestic support through the reduction of domestic prices. Besides, the reform will prepare the EU for the opening of its sugar market for LDCs in the frame of the Everything-but-Arms initiative.

Whether EBA countries will benefit from the reform depends on the level of domestic prices in the EU once the transitional period is completed. Assuming that these will follow the level of cost of the most competitive EU country (say, France), many EBA countries will still be in a position to supply sugar to the EU. Those that

are less competitive will lose market share. The ACP countries among them should be compensated for the ensuing loss in export earnings.

The WTO negotiations can also cause the U.S. to reform its sugar policies. The tariff reduction and quota expansion mandated by the July 2004 'Doha Work Programme' will improve access to the American market.

Reform of trade-distorting agricultural policies of developed countries can only be achieved by multilateral negotiations and dispute settlement. Therefore, the WTO and the developing-countries' position in it should be strong. The formation of the G-20 was a very important step in this direction. At the time of writing, the results of the Doha Round were still unknown. However, it can be expected that the outcomes will be more in line with the needs of developing countries than those of the Uruguay Round.

NOTES

- ¹ White-sugar weight is converted to raw-equivalent weight by a factor 1.08. All information about quantity mentioned in this paper is denominated in raw equivalent.
- ² This figure does not take into account the intra-EU trade.
- ³ Saudi Arabia and the United Arab Emirates import raw sugar from Latin-American countries and sell the excess of white sugar to border countries.
- ⁴ The free market is the total trade minus the preferential imports and in-quota imports. In order to calculate the free market based on the USDA data, it is necessary to subtract from the total market the U.S. imports, the EU trade (exports and imports) – which already include the ACP and India exports to the EU – and the exports of Cuba to Russia. It is not necessary to perform the same calculation for the intra-tons EU trade because the USDA data do not take it into consideration.
- ⁵ The total amount of transfers under the MLP depends on the total current production and on the difference between the loan rate and the adjusted world price (the AWP is equivalent to the CIF Northern Europe price adjusted to U.S. base quality and average location). The marketing loan programs – Marketing Assistance Loan, Loan Deficiency Payment and Certificate Exchange Gains – although not working in the same way, have a very clear objective: to cover the price-gap differential between the market prices and the fixed rate (loan rate).
- ⁶ In order to follow similar principles of direct payments, payment acreage is set at 85% of base acreage.
- ⁷ This payment was activated when the following two conditions were met: (i) the price of U.S. cotton delivered in Northern Europe (USNE) exceeded the Northern Europe (NE) price by more than 1.25 cents per pound for four consecutive weeks; and (ii) the AWP was within 134% of the base loan rate. Payments were made available to domestic users of cotton consumed at the mill and to eligible exporters. The payment rate is equal to the difference in the fourth week of the four-week period between the USNE and the NE prices.
- ⁸ In order to respond to the cotton panel's findings, the U.S. government has eliminated the GSM-103 program and has implemented some modifications to GSM-102 and SCGP programs. Since October 2005, both programs work with risk-based fees as a way to ensure that such fees cover long-term operating costs and losses.
- ⁹ Four other trade-distorting instruments were notified in the 1995-2001 period: the Georgia Cotton Indemnity (1998); Cotton Seed Payments (1999 and 2000); Storage Payments (1997-2001); and the Commodity Loan Interest Subsidy (1998-2001).
- ¹⁰ Today many countries with quotas are not able to produce sugar and they must import to complete their volumes.
- ¹¹ The ACP/India, CXL and EBA quotas apply only to raw sugar for refining. If refineries cannot source sufficient quantities via these quotas, a tariff quota at zero duty for raw cane sugar for refining, known as Special Preferential Sugar (SPS), is open to ACP countries.
- ¹² Common organization of the markets in the sugar sector (COM), COUNCIL REGULATION (EU) n° 318/2006 of 20 February 2006.

¹³ See FAO (2004) for a full analysis of those studies.

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