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I

*(Information)*

# COURT OF AUDITORS

## SPECIAL REPORT No 4/91

**on**

**the operation of the common organization of the market in the sugar and isoglucose sector together with the replies of the Commission**

(91/C 290/01)

*(Observations pursuant to Article 206a (4) of the EEC Treaty)*

**The first part of this report consists of a presentation of the common organization of the sugar market, whereas the second, third and fourth parts analyse the consequences of the way the organization that has been thus created operates.**

**Those readers who have not the time to read all of the report will find its conclusions set out in the fifth part.**

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# 1. PRESENTATION OF THE COMMON ORGANIZATION OF THE MARKET

## *Sugar and isoglucose in the Community: agricultural and industrial aspects*

### General matters

1.1. Sugar is traditionally a basic foodstuff. It corresponds to one of the four essential tastes, the others being acid, bitter and salty. Its widespread use dates back to the early 19th century, when the sugar beet was discovered and the industrial development of cane-sugar refining began. Whilst sugar consumption has reached saturation level in the developed countries, this does not apply to the poor countries where consumption is directly dependent on income and the price of sugar. The world average per capita consumption amounts at present to about 20 kg of white sugar a year. Total world consumption rose by more than 60 % between 1968 and 1988 and this upward trend is continuing, mainly because of increasing use in the developing countries. Average per capita consumption in the European Community is about 34 kg of white sugar a year, with the national averages ranging from 25 kg (in Spain) to 40 kg (in the United Kingdom). Overall, per capita sugar consumption is more or less stable in the Community, whereas more sugar substitute products are starting to penetrate the market. It is important to note that only some of the sugar consumed is sugar as such, the majority being incorporated into foodstuffs. The ratio between these two amounts varies according to the country but for the Community as a whole it is around one third for direct use and two thirds for consumption in the form of processed products. It is above all in the latter category that sugar substitutes are being used.

### Agricultural aspect

1.2. Sugar (sucrose) is, chemically speaking, a disaccharide which is made up of equal parts of fructose and glucose and can be obtained from sugar beet in temperate regions and from sugar cane in tropical areas. Isoglucose is a liquid with the same chemical properties which can be manufactured from (preferably) maize starch or from wheat or even potatoes. Most of the sugar production in Europe is based on the sugar-beet crop, introduced by Napoleon at the time of the Continental System. Within a very short space of time, sugar-beet factories sprang up all over Europe. Since then, the world sugar economy has been characterized by the cane/beet duality, depending on the climate of the area, thus making sugar a truly international product. Today, about 63 % of world sugar production comes from sugar cane and 37 % from beet. Sugar beet is a plant which is sown in spring and harvested in autumn. The cane crop, by contrast, has a seven-year cycle. The yields from both crops are strongly influenced by climatic and weather conditions. Cane plantations are exposed to tropical storms and may be in the path of hurricanes. The yields of a beet crop, in terms of both the amount harvested per hectare and the sucrose content, depend firstly on the climatic area — the north of Europe giving better yields than the south — and secondly on the weather conditions. The latter factor may result in good or bad harvests, marked by a difference in yield of between 15 % and 20 %. The yield of the beet crop is steadily improving as a result of new developments in biotechnology and mechanization of farms. In the field of biotechnology, the introduction of monogerm seed (eliminating the laborious job of thinning-out) and the development of varieties which are resistant to some diseases have helped to improve yields considerably: over the last 20 years, the average increase in yield in the Community (expressed in terms of white sugar per hectare) has been in the order of 1,2 % per year.

### Industrial aspect: a heavy industry

1.3. One of the main features of sugar is that the basic agricultural production has of necessity to be combined with an industrial process. Neither sugar beet nor sugar cane can be consumed in its natural state; both have to be converted into sugar by means of a relatively complex extraction and refining process, which requires specialized, technologically advanced, heavy-investment plant. A modern sugar-beet mill, processing about 10 000 tonnes of beet a day, represents an investment of some 150 Mio ECU. It is a heavy industry in the true sense of the word, i.e. complexes of large-scale technical plant. Furthermore, the raw material, beet, poses an economic problem relating to transport costs, because of the transportation of unnecessary weight (between 85 % and 90 % of low-value residue). Consequently, the sugar-beet factories have to be located near to the beet fields, at a distance of no more than 50 km or at the very most 100 km.

1.4. The final product — crystals of white sugar — resulting from the process of extracting and refining the beets is indistinguishable both physically and chemically from that obtained from sugar cane. Brown or unrefined cane sugar is an intermediate product, based on cane, which has undergone an initial refining on the spot so that it can be stored and which is then in most cases transported to the regions where it is to be consumed, for final refining.

The reason for this division of the labour is threefold: raw sugar is relatively easy to transport in bulk; the cost of the plant needed for the final refining is high and special skills are required to operate it; and, traditionally, there has been a desire to exercise economic control. The refineries which process the raw cane sugar thus have a considerable economic advantage over sugar-beet factories insofar as they can run continuously whereas sugar-beet mills operate only during a 'season' lasting about three months per year. Brownish-coloured sugars for consumption, such as soft brown sugar or brown candy sugar, can be obtained either from beet or cane: they are refinery products which differ from white sugar only by their type of crystals and by the fact that they contain a small quantity of molasses (a syrupy, impure by-product).

1.5. The fact that an industrial complex forms an integral part of this basically agricultural sector of production has a number of important consequences:

a) firstly, the sugar factories represent a relatively small number of compulsory transition points. At present, the Community has no more than 200 sugar mills, belonging to fewer than 100 companies. This is a great advantage in the field of both physical and financial checks and consequently makes it easier to implement effective market-management instruments. But this arrangement means that it is easy for the companies to confer together in order to defend their common interests. This concentration has been increased in recent years by a trend towards mergers;

b) at the same time, technological changes are helping to modernize and enlarge the average size of the production units, thus allowing an increase in the industry's productivity. If to the latter one adds the improvement, mentioned in paragraph 1.2, of the technical agricultural yield, the overall increase in technical productivity in the sugar sector represents on average 1,4 % per year, for the Community countries, over the last 20 years;

c) with regard to isoglucose, the relationship between the industrial and the agricultural aspects is weaker: isoglucose is a product obtained from another product which is already intermediate (starch); it is only one of many other derivatives of starch, all of which are marketed. Moreover, the economic problem which is a feature of sugar beet — that of having to transport unnecessary weight (see paragraph 1.3) — does not apply to the same extent, with the result that there are far fewer restrictions applying to the geographic location of the factory in relation to the agricultural production land;

d) a further consequence of the role played by a high-investment industrial complex is the need for management planning: the level of production cannot be changed from one year to the next without creating economic problems for the firms. If production needs to be altered, these changes have to be made known several years in advance so that the companies can take account of them in their modernization and restructuring plans. A fitting comparison is that of sailing a super-tanker: in order to change course, manoeuvres have to be started well in advance;

e) the size of the investments also means that the sugar refineries are part of large companies, some of which are highly diversified, in the agri-foodstuffs sector. Especially in the last few years, these companies have increasingly been the target of transnational mergers.

**Production and consumption in the Community**

1.6. During the Eighties, total sugar consumption in the Community remained relatively stable: around 9,5 Mio t of white sugar prior to the accession of Spain and Portugal and about 10,9 mio t afterwards. Present production stands at nearly 14 Mio t, plus about 1,7 Mio t of imports. Given domestic consumption needs, these quantities result in exports of some 4,8 Mio t per year. ***Table 1*** shows the sugar supply balances for the Community since 1981.

## *The common market in sugar and isoglucose*

**Setting-up of a common organization of the market**

1.7. When the common organization of the market (COM) in sugar was set up in 1968, it replaced the national sugar policies of the Member States of that time. In order to do that, a major alignment was needed to bridge the differences between these national policies. Traditionally, in all the sugar-producing countries, this sector has always been highly regulated and protected by the national authorities. Since the natural conditions for beet production vary from one country to another, the regulating arrangements and, in particular, the institutional price levels differed considerably between the Member States concerned in 1968. For example, in Italy and the FR of Germany production was guaranteed at a price level that was much higher than for the production of other countries, the disparity being in some cases as much as 50 %.

**Table 1 — Supply balance sheets for Community sugar**

*(in 000s of t)*

| Marketing year | 1 Stocks at beginning of year | 2 Production | 3 Imports | 4 Total resources | 5 Consumption | 6 Exports | 7 Total uses | 8 Stocks at the end of the year |
|---|---|---|---|---|---|---|---|---|
| 1981/82 | 1 120 | 15 028 | 1 532 | 17 680 | 9 597 | 5 473 | 15 070 | 2 610 |
| 1982/83 | 2 610 | 13 942 | 1 493 | 18 045 | 9 474 | 5 516 | 14 990 | 3 055 |
| 1983/84 | 3 055 | 11 003 | 1 543 | 15 601 | 9 314 | 4 416 | 13 730 | 1 871 |
| 1984/85 | 1 871 | 12 500 | 1 525 | 15 896 | 9 555 | 4 230 | 13 785 | 2 111 |
| 1985/86 | 2 111 | 12 720 | 1 469 | 16 300 | 9 391 | 4 570 | 13 961 | 2 339 |
| Average | 2 153 | 13 039 | 1 512 | 16 704 | 9 466 | 4 841 | 14 307 | 2 397 |
| 1986/87 | 2 752 | 14 096 | 1 704 | 18 552 | 10 907 | 4 869 | 15 776 | 2 776 |
| 1987/88 | 2 776 | 13 211 | 1 790 | 17 777 | 10 834 | 4 608 | 15 442 | 2 335 |
| 1988/89 | 2 335 | 13 915 | 1 795 | 18 045 | 10 861 | 5 118 | 15 979 | 2 066 |
| Average | 2 621 | 13 741 | 1 763 | 18 125 | 10 867 | 4 865 | 15 732 | 2 392 |

### Periodic reviews

1.8. The basic regulations governing the sugar market are subject to periodic reviews, in theory every five years, except for the first Regulation (1), which was to be reviewed after seven years. The second Regulation (2), of 19 December 1974, was to be renewed after five years, i.e. with effect from 1 July 1980. Because of the political difficulties which arose during the negotiations, the third sugar scheme was not able to start in 1980 and, after the 1975-1980 scheme had been extended for one year, came into force on 1 July 1981 (3). The following review was carried out as planned in 1986, with the result that the next renewal of the basic regulations is due on 1 July 1991. On 6 August 1990, however, the Commission proposed for the most part to extend the 1986-1991 arrangements by two years (4). The Council accepted the principle of such an extension and adopted, for this purpose, Regulation No 305/91 of 4 February 1991.

(1) Council Regulation No 1009/67/EEC of 18 December 1967 on the common organisation of the market in sugar, OJ No L 308, 18. 12. 1967, p. 1.

(2) Council Regulation No 3330/74 of 19 December 1974 on the common organisation of the market in sugar, OJ No L 359, 31. 12. 1974, p. 1.

(3) Council Regulation No 1785/81 of 30 June 1981 on the common organisation of the market in sugar, OJ No L 177, 1. 7. 1981, p. 4.

(4) Proposal for a Council (EEC) regulation amending Regulation (EEC) No 1785/81 on the common organisation of the market in sugar, submitted by the Commission, doc. COM(90) 323 of 26.9.1990. This proposal led to Council Regulation (EEC) No 305/91 of 4 February 1991 (OJ No L 37, 9. 2. 1991).

### Accessions

1.9. The reviews of the sugar regulations have more or less coincided with the accession of new Member States to the Community, a fact which has not been without consequence. The second Regulation, dating from 1975, was heavily influenced by the accession in 1973 of Denmark, Ireland and above all the United Kingdom. The 1981 review coincided with the Greek accession and that of 1986 with the accession of Spain and Portugal. Similarly, the preparations for the scheme's renewal, planned for July 1991, took place just at the time when the territory of the former German Democratic Republic was being integrated into the area of application of the common organization of the market in sugar. In all these cases, the sugar sector has assumed considerable significance in the political negotiations and the organization of the market reflects the consequences of this.

### Isoglucose

1.10. During the Seventies, isoglucose was introduced onto the market as a substitute sweetening agent, first in the United States and Japan and then in Europe. It was once a certain production capacity had been set up in Europe and isoglucose began to compete with sugar that restrictive measures against it were taken, in 1977 and then in 1979. Isoglucose was dissociated from the starch arrangements and incorporated instead in the common organization of the market in sugar. Since then its production has been restricted by the quota system.

## *The mechanisms by which the system is managed*

### Production quotas

1.11. From the outset (1968), a main feature of the sugar scheme was the limitation of the guaranteed prices, which made it unique at the time. This limitation takes the form of production quotas. These quotas are allocated in two stages. Firstly, a maximum quota is fixed for each Member State. These are recorded in the basic Regulation governing the COM. Secondly, the Member States allocate quotas to the companies in accordance with rules laid down for this purpose by the Council.

1.12. The maximum quota is made up of a basic or A quota and a specialization quota or B quota. In the first Regulation, that of 1967 [1], the B quota was fixed at 35 % of the A quota [2]. The B quota was intended at the outset to be a specialization quota and therefore its price level was lower, as a result of the charging of levies. This additional production was intended to compensate, where necessary, for a poor harvest in some regions of the Community or, usually, for export. It was supposed, logically, to be produced in the regions where it was economically profitable.

1.13. Quantities produced over and above each company's maximum quota (so-called 'C' sugar) do not receive any Community guarantee and have to be exported entirely at the expense of the company concerned within a period stipulated in the Regulation. This principle is nevertheless made more flexible by the possibility, provided for in the Regulation [3], of carrying over part of the C sugar to the following marketing year, thus enabling it to be entered in advance against the new year's production. The quantities in question then have to be stored for a period of twelve months. This facility is limited to 20 % of the company's A quota. It is combined with a permanent obligation imposed on sugar producers to keep a minimum stock of 5 % of their annual production of A sugar.

1.14. The production-quota mechanism described above was incorporated into the basic Regulation governing the first sugar scheme as a transitional provision. The first Regulation expressly stated that these transitional provisions were to be repealed on 1 July 1975 [4]. The quota system has, however, for the most part been prolonged (in 1975, 1981 and 1986) and still applies today. Isoglucose, since being incorporated into the sugar COM regulations, is part of the same system.

1.15. The basic Regulation provides for yet more flexibility, throughout the duration of the system, insofar as Member States may redistribute part of the sugar and isoglucose quotas amongst the companies in relation to the situation at the beginning of the period. This part, called the 'reserve quantity', is at present limited to 10 % of the maximum quota [5].

### The prices

1.16. The sugar scheme differs little from most of the other markets, with regard to the system of official prices. It has a target price, an intervention price and a threshold price. A special, fundamental feature, however, is that the price system is applied to the final product, sugar, in such a way that the price of the agricultural raw material, sugar beet, is derived from it. The cornerstones of the present system are as follows:

a) a target price for white sugar: this represents the level of market price considered by the Council to be the most desirable; it is fixed for the standard quality, ex-factory;

b) an intervention price for white sugar: this is 5 % lower than the target price and represents the price at which the intervention agencies have to purchase the sugar brought to them;

c) a derived intervention price for white sugar: in regions of the Community regarded as having a sugar deficit, a slightly higher intervention price is applied in order to take account of the transport costs from the regions having a sugar surplus to those with a deficit. In practice, this means three Member States: Ireland, Italy and the United Kingdom. In Spain and Portugal, a higher price has been applied as a transitional measure following their accession in 1986;

d) a threshold price: this is equal to the target price in surplus areas, plus transport costs, calculated at a flat rate, from the area having the largest surplus (northern France) to the most distant deficit area (southern Italy) and plus a lump sum taking account of the storage levy. This price is used mainly for fixing the levies and refunds referred to in paragraphs 1.17 and 1.18 below;

(1) Council Regulation No 1009/67/EEC of 18 December 1967 on the common organisation of the market in sugar, OJ No L 308, 18. 12. 1967, p. 1.
(2) Article 26 of Regulation No 1009/67/EEC. See Note 1.
(3) Latterly, Article 27 of Council Regulation (EEC) No 1785/81. See Note 3.
(4) Article 22, first paragraph, of Regulation No 1009/67/EEC. See Note 1.
(5) Article 25 of Council Regulation (EEC) No 1785/81. See Note 3.

e) an intervention price for raw sugar: this is derived from the intervention price for white sugar by applying a uniform processing margin and a white/raw yield coefficient of 0,92;

f) a minimum price for beet: this is established on the basis of the intervention price for white sugar, by deducting from that price uniform rates for the processing margin and, where appropriate, for the costs incurred in delivering beets to factories, adding to it receipts from sales of molasses and taking into account a standard yield (130 kg of white sugar for one tonne of standard quality beets, i.e. with a 16 % sugar content). The beet growers and the sugar manufacturers are free to agree a higher price in their trade contracts. Also, instead of fixing a price for A beets and a price for B beets, they may fix a mixed price for the two combined. The Regulation stipulates that agreements within the trade and contracts concluded between buyers and sellers of beet must conform to outline provisions, in particular in respect of conditions governing purchasing, delivery, reception and payment of beets.

These prices are used as a basis for calculating the amounts of the levies, refunds and aid referred to in the following paragraphs. The prices are usually fixed before the beginning of each marketing year, which runs from 1 July to 30 June. The Regulation even lays down that the intervention price must be fixed prior to 1 August of the year preceding the marketing year beginning on 1 July of the following calendar year.

## The other aspects

*Rules on importation*

1.17. Like the other products subject to a common market organization, sugar and isoglucose are protected at the Community frontiers from imports coming from third countries; this protection takes the form of a system of import levies. This levy is calculated as being the difference between on the one hand the threshold price and on the other a c.i.f. price representing the most favourable purchasing price on the world market. In practice, very little sugar is imported into the normal scheme in the Community. The same is not true for molasses, a syrupy residue from the manufacture of sugar, containing 40 % to 50 % of sugar and used mainly for cattle feed. The Community has a molasses deficit of about 3 million tonnes and on these imports a levy is charged. By contrast, there are major exceptions to the normal importing system: a quantity consisting chiefly of raw sugar to be refined in the Community, equivalent to around 1,3 million tonnes of white sugar, is imported every year from a number of ACP countries, without an import levy and at prices similar to the guaranteed Community prices (see the second part and paragraphs 3.21-3.22 of the third part of this report). In addition, a large quantity of raw sugar has been imported each year since 1986 at a reduced tariff rate, in order to guarantee supplies to the Portuguese refineries. This concession was granted in the Accession Treaty and during the 1989/90 marketing year the quantity imported under this arrangement amounted to 281 000 tonnes of white sugar equivalent.

*Rules on exportation*

1.18. As on the other markets, there are export rules intended to bridge the gap between the guaranteed Community price and the (usually lower) world price by means of export refunds or export levies in the (very rare) event of the world price being higher. For sugar, there are two procedures, designed to meet the needs of the trade: that of weekly invitations to tender (submission of tenders of proposed refund rates for given quantities with the lodging of a deposit in the Member States; decision on the maximum amount taken by the Commission in consultation with the Management Committee) and that of periodic fixing (i.e. a rate fixed by the Commission once or twice a month, with the possibility of adjusting it in between in keeping with changes in the world price). In practice, by far the majority of exports are subject to the weekly invitations to tender. Smooth running of operations is ensured by a system of export licences, issued by the competent authorities of the Member States and accompanied by the lodging of a deposit, to be released on presentation of proof that the goods have in fact been duly exported within the period of validity of the licence. A system of licences is also provided for in the case of C sugar, which, if no export refund can be claimed, must, however, be exported within a period of time laid down in the Regulation.

*Food aid*

1.19. As in other agricultural sectors, the Community may make white sugar available as food aid. This may be done under special arrangements, whose aim is primarily humanitarian and which are implemented according to rules applicable to all the agricultural sectors. There are no arrangements peculiar to sugar. On average, the Community spends around 2 Mio ECU a year on sugar food aid, although in 1990 and 1991 this amount was rising.

*The system of production refunds for the chemical industry*

1.20. A measure which is virtually comparable to the export provisions and at any rate serves the same purpose, i.e. the disposal of surpluses, has been implemented to subsidize the use of sugar by the pharmaceutical and chemical industries. This measure, which previously existed in another form, was reintroduced in 1986. Its aim is to put the manufacturers concerned on an equal footing with their competitors outside Europe, who are able to obtain their raw material at world prices; at the same time, within the Community, it aims to make sugar competitive with starch products. The amount of the refund is fixed every quarter and the calculation of the amount used to take account of the price of sugar, the price of maize, production aid granted to starch products and changes in the price of sugar on the world market. Since 1 July 1990 the system has been completely separated from the glucose market and refund rates are now calculated exclusively on the basis of Community and world sugar prices. The administrative implementation of the measure, by the competent authorities of the Member States, is based on a system of issuing refund orders accompanied by the lodging of deposits, which are released once it has been ascertained that the orders have been used properly.

*Storage*

1.21. The sugar scheme includes, in principle, an intervention mechanism in the form of public storage. Any sugar owner may offer quantities of sugar to an intervention agency designated for this purpose and the agency is obliged to buy it at the intervention price or the derived intervention price, depending on the case. In practice, however, operators use this measure only in very rare cases, since the sugar scheme has a unique compensation system for storage costs, which enables the operators to keep control of the sugar. This compensation system involves paying to sugar stock-holders situated in the circuit of the producing-processing industry and the wholesale trade monthly allowances for storage costs. The latter are financed by levies charged to sugar manufacturers for the quantities produced as part of their maximum quota. These storage allowances are also paid on quantities of C sugar carried over to the following marketing year, during their compulsory 12-month storage period. The amount of the allowance is fixed by the Council for each marketing year, taking into consideration the financial costs, insurance costs and technical storage costs as such. The amount of the levy is established by the Commission, for each marketing year, according to the Management Committee procedure, so that the estimated total sum of the allowances is equal to the estimated total sum of the levies, whilst at the same time eliminating any disparity between the two which may have arisen from the preceding period. Financially speaking and seen over a number of years, it is therefore a closed, balanced circuit.

## *The COM's financial and budgetary system*

**Budgetary nomenclature**

1.22. In the Community budget, there are specific headings for sugar in both the revenue part and the expenditure part. For 1990 and 1991, the part of the budget devoted to sugar was presented as described in ***Table 2***. To be complete, this table ought to include import levies in the revenue section and export refunds for the sugar content of processed products in the expenditure section, but these items cannot be identified separately in the accounts. It should, moreover, be noted that the remark relating to budget heading 1119, expenditure for 'other intervention', is incorrect. It mentions denaturing premiums, a measure which has not been used for a long time. What is in fact booked to this heading is aid, in particular aid for refining.

**Financing provisions**

1.23. After the quota system described in paragraphs 1.10-1.14, the second major original aspect of the scheme, which has been a feature of it since the very outset, is the principle of co-responsibility of producers for financing the costs engendered by disposing of surplus production. Unlike the disposal of C sugar, the costs of which are borne by the individual manufacturers themselves, there is a true sharing of the costs arising from the production of quota sugar destined for export, therefore roughly speaking B sugar. To this end, the Member States charge the sugar manufacturers production levies, the unit amount of which is calculated by dividing the overall cost of disposing of the surplus by the quantities produced, without, however, exceeding a maximum. The amount of the levy varies as a rule from one marketing year to another. It is calculated provisionally for each marketing year and then adjusted in accordance with actual changes in the quantities and costs. The sugar manufacturers bear 40 % of the levies themselves and pass on 60 % to the beet growers by means of the price actually paid for the beets.

1.24. The detailed rules of this system have changed over the years. Initially, only quantities produced over and above the basic Community quota, within the limit of the

**Table 2 — Budgetary nomenclature: 1990 and 1991 budgets**

*(in ECU)*

| Heading | 1990 | | 1991 | |
|---|---|---|---|---|
| | Article item | Appropriations | Article item | Appropriations |
| *Revenue* | | | | |
| Sugar production levies | 110 | 609 850 000 | 110 | 650 230 000 |
| Sugar storage levies | 111 | 497 097 000 | 111 | 445 936 000 |
| Isoglucose production levies | 112 | 5 164 000 | 112 | 5 228 000 |
| Charges levied on non-exported C sugar and isoglucose production | 113 | p.m. | 113 | p.m. |
| Charges levied on substituted C sugar and isoglucose | 114 | p.m. | 114 | p.m. |
| Elimination levies provided for in Council Regulation (EEC) No 934/86 | 115 | 88 985 000 | 115 | 92 008 000 |
| Additional levy provided for in Council Regulation (EEC) No 1107/88 | 118 | 183 504 000 | 116 | 19 233 000 |
| Total for Chapter 11 | | 1 384 600 000 | | 1 212 635 000 |
| Levy refunds − 10 % (1) | | 138 460 000 | | 121 263 500 |
| Net revenue | | 1 246 140 000 | | 1 091 371 500 |
| Expenditure | | | | |
| Refunds on sugar and isoglucose | 110 | 1 481 000 000 | B1-110 | 1 209 000 000 |
| Reimbursement of storage costs | 1110 | 506 000 000 | B1-1110 | 533 000 000 |
| Public storage | 1111 | 1 000 000 | B1-1111 | 1 000 000 |
| Refunds on sugar used in the chemical industry | 1112 | 99 000 000 | B1-1112 | 83 000 000 |
| Measures to aid the disposal of raw sugar | 1113 | 25 000 000 | B1-1113 | 24 000 000 |
| Import subsidies | 1114 | p.m. | B1-1114 | p.m. |
| Depreciation of stocks | 1115 | p.m. | B1-1115 | p.m. |
| Other intervention | 1119 | 13 000 000 | B1-1119 | 23 000 000 |
| Total for Article 111 | | 664 000 000 | | 664 000 000 |
| Total for Chapter 11 | | 2 125 000 000 | | 1 873 000 000 |
| Refunds on sugar food aid measures | 2922 | 2 000 000 | B1-332 | 2 000 000 |
| Sugar food aid | 922 | 3 200 000 | B7-202 | 4 800 000 |

(1) Included in revenue Chapter 19.

companies' maximum individual quotas, were concerned, i.e. B sugar. The amount of the levy, in the Regulation governing the 1968-1975 system [1], was subject to an upper limit of 40 % of the intervention price. The second sugar Regulation [2] brought this ceiling down to 30 %.

1.25. Furthermore, when imports of sugar (whether or not preferential) enter the Community to supply the common market, either on conditions that treat them as equivalent to Community-produced sugar (usually more than 1 300 000 tonnes) or at the reduced tariff rate (almost 300 000 tonnes) or at the normal tariff rate (negligible quantities compared with total market volume), these imports have the effect of increasing by a similar amount the quantities to be exported from the Community, which is already more than self-sufficient in sugar. But these exports are not — rightfully — taken into account when charging the production levies and their costs are therefore borne by the budget.

1.26. The provisions relating to the levies have subsequently changed in accordance with the detailed rules analysed below in paragraph 2.19 onwards.

## *The audit's objectives and detailed arrangements*

### The Court's earlier observations

1.27. In the past, the Court has made observations on the sugar market, in particular in its annual reports on the financial years 1985, 1986 and 1988 [3]. In its 1985 and 1986 reports, the Court examined the situation with regard to the self-financing by producers of the costs of disposing of surplus production, a mechanism which was provided for in the 1981 sugar Regulation but which was not achieving its objective. The Court pointed out that a considerable deficit had accumulated in this sector and stressed the need for immediate measures to ensure that this deficit was rapidly covered by adequate levies, that new deficits did not arise and that the specific financial situation was shown clearly in the budget and accounts. In its report on the financial year 1988, the Court presented its observations following an examination of, firstly, the procedures implemented by some Member States with regard to the management and checking of export refunds and, secondly, the Commission's expenditure and revenue accounts. On the first subject, the Court found that there were disparities between the systems implemented by the different Member States and that there were shortcomings in Community checks. Furthermore, the Court presented an evaluation of the cost to the Community budget of exports of French or Belgian sugar which pass through Dutch ports and are declared at the Dutch paying agency, thus giving the operator an advantage stemming in particular from exchange rate differences. With regard to the central accounting system, which was examined in particular from the point of view of the self-financing objective, the Court found that the accounting system, in its present form, did not lend itself to an ex post facto check on whether the objective was being met. In order to comply with the request made by the Council in its recommendations on the 1988 discharge and with the Parliament's resolution on this discharge, the latter problem will be dealt with in more detail in this report.

### The audit's objectives

1.28. Bearing in mind that the COM is now more than 20 years old and that the fourth scheme is drawing to an end, the Court decided to carry out an audit of the whole of the scheme in order to assess 'whether the financial management has been sound' (in accordance with Article 206a(2) of the EEC Treaty). The purpose of the audit was, more particularly, to examine the economic effectiveness of the organization of this market, with particular reference to the principles set out in Articles 39 and 40 of the Treaty and those concerning the control of surpluses in the agricultural sector, and the related expenditure, which emerged during the 1980s. It drew the conclusions that followed, as far as the Community finances are concerned, from the characteristics thus brought to light. In view of the forthcoming periodic review of the system (in principle planned for 1991 but now, after the decision to grant a two-year extension, postponed until 1993 [4]), it is essential in this context to establish what lessons can be learnt, for the purpose of determining the new scheme, from the practice followed in the past and from the present situation which has thus arisen.

(1) Council Regulation No 1009/67/EEC of 18 December 1967 on the common organisation of the market in sugar, OJ No L 308, 18. 12. 1967, p. 1.

(2) Council Regulation No 3330/74 of 19 December 1974 on the common organisation of the market in sugar, OJ No L 359, 31. 12. 1974, p. 1.

(3) Annual report concerning the financial year 1985, OJ No C 321, 15. 12. 1986, pp. 35-36.
Annual report concerning the financial year 1986, OJ No C 336, 15. 12. 1987, pp. 42-43.
Annual report concerning the financial year 1987, OJ No C 312, 15. 12. 1989, pp. 87-99.

(4) Proposal for a Council (EEC) regulation amending Regulation (EEC) No 1785/81 on the common organisation of the market in sugar, submitted by the Commission, doc. COM(90) 323 of 26.9.1990. This proposal led to Council Regulation (EEC) No 305/91 of 4 February 1991 (OJ No L 37, 9. 2. 1991).

**Arrangements for the audit**

1.29. In order to take stock of the present state of the market and how it actually operates, the Court staff visited all the Community's sugar-producing countries, i.e. all the Member States except Luxembourg. During these visits, they interviewed representatives of all the parties involved, i.e. the beet-sugar manufacturers and cane-sugar refiners, the isoglucose manufacturers, the beet growers, the sugar traders and exporters, the representatives of the agri-foodstuffs industry which uses sugar and/or isoglucose, and of the chemical industry which uses sugar in return for production refunds, the consumers' unions, the national departments responsible for the management of the market at national level and the competent departments of the European Commission. They also consulted representatives from university circles and from international organizations, such as the ISO (International Sugar Organization). Statistical and economic analyses are mainly based on data gathered from the European Commission, the CEFS (European Committee of Sugar Manufacturers), the FIRS (Fonds d'Intervention et de Régularisation du marché du Sucre, the French managing body) and the ISO. Furthermore, the Court commissioned the Institute of Agricultural Economics of the University of Kiel to make an in-depth study of the economic aspects of C sugar.

## 2. THE INTERNAL MACRO-ECONOMIC CONSEQUENCES OF THE COMMUNITY SCHEME

### *Background to the quota system*

**The first sugar scheme (1968-1975)**

2.1. With the institution of the first sugar scheme, which entered into force in 1968, a system of production quotas was devised in order both to limit the price guarantees to producers in quantity terms and to demarcate the various production areas. In its introduction to the Regulation of 18 December 1967 (1) the Council stated that during previous years Community production had exceeded consumption on several occasions and that the world market situation was one of large surpluses. It had concluded from that that provision should be made for measures to limit production and promote regional specialization (2) (3). A limit on production was ensured by laying down basic quantities, determined specifically for each Member State in the Regulation (4).

2.2. These quantities were based on past production, on the one hand and on negotiations, including the offsetting of the effects of agreements concluded in other sectors, on the other hand. As a result, some countries, in particular Belgium and Italy, were granted quotas that exceeded the mathematical level of their reference production quantities. It was then up to the Member States to establish the following:

a) for each factory or for each undertaking producing sugar on their territory, a basic quota (or A quota), established by applying a formula to calculate the ratio of each factory's or undertaking's average annual production over a reference period to the Member State's total production, as well as to the latter's statutory basic quantity (3). These quotas benefited from the intervention price guarantee;

b) secondly, each Member State was to fix a maximum quota for the factories or the undertakings for which it had fixed a basic quota by applying a coefficient which was initially set at 1,35 and which would consequently be adjusted in the light of the actual trend of production from the point of view of specialization and marketing opportunities (5).

2.3. Quantities produced by each producer that were in excess of its basic quota but which did not exceed its maximum quota (so-called B quota quantities) were subject to the production levy (6). This levy was calculated globally, on the basis of the disposal costs of the quantity that was produced in the Community in excess of the guaranteed quantity but within a certain ceiling. Moreover, this levy was supposed to be passed on, in part, to the cane or beet growers. In this way a principle of limited co-responsibility was introduced into the system.

2.4. Any quantities produced beyond the maximum quotas (C sugar) would not benefit from any guarantee, except where a grower wished to carry forward that part of his production which was outside the basic quota to the following marketing year. In that case it would be counted as part of the basic production of that marketing year. This facility was, however, limited in the 1967 Regulation to 10 % of the basic quantity (7).

(1) Council Regulation No 1009/67/EEC of 18 December 1967 on the common organisation of the market in sugar, OJ No L 308, 18. 12. 1967, p. 1.

(2) Ninth recital of Council Regulation No 1009/67/EEC of 18 December 1967. See Note 1.

(3) The question of regional specialization is looked at in detail in paragraphs 2.35-2.39 of this report.

(4) Article 23 of Regulation No 1009/67/EEC. See Note 1.

(5) Article 24 of Regulation No 1009/67/EEC. See Note 1.

(6) Article 27 of Regulation No 1009/67/EEC. See Note 1.

(7) Articles 25 and 32 of Regulation No 1009/67/EEC. See Note 1.

2.5. In this first scheme the quantities produced outside the guaranteed quantity were seen as 'specialized production'. This part of production was supposed to be concentrated in those regions where it was possible to produce profitably, taking into account the deduction of the levy from the sales proceeds.

2.6. Given that the basic quantities, and therefore the maximum quantities, were fixed Member State by Member State, they had the effect, besides limiting production, of giving each Member State, and in fact each undertaking in a Member State, the right to produce, at the guaranteed price, at least its basic quantity, which depended on the level of its previous production. This statutory apparatus thus consisted in consolidating the existing situation prior to the creation of the common market organization, and then adding to it a facility for increasing production, the disposal of which was to be financed, at least in part, by the producers of the additional quantities. Throughout the duration of the first scheme the specialized quantity allowed varied between 30 and 45 % of the basic quantity.

2.7. This aspect of the first scheme was intended to be a transitory arrangement which would make it possible, over a seven-year period, to align and harmonize the sugar economies of the founding Member States. Article 22 of the Regulation stipulated expressly that 'the provisions concerning national basic quantities (and) their distribution between factories or undertakings (....) shall be repealed with effect from 1 July 1975'.

2.8. Harmonization was facilitated by a common price level which was clearly advantageous for producers in most of the Member States, and it was accompanied by the authorization, which was also temporary, to grant national aid for cases where this price still posed a problem, i.e. in Italy.

**The second sugar regulation and the first enlargement of the Community (1975-1981)**

2.9. When the time came, in 1973 and 1974, to prepare the renewal of the scheme, which was planned for 1975, the market situation was quite unusual, in that it was characterized by the coincidence of two significant factors: the enlargement of the Community to include Denmark, Ireland and the United Kingdom and a serious world-wide sugar shortage.

2.10. The accession of the three new Member States not only posed a problem as to the geographical distribution of production and consumption in Europe, but also brought with it the problem of the traditional imports to the United Kingdom of raw cane sugar, mainly from a number of Commonwealth countries. Two-thirds of sugar consumption in the U.K., i.e. approximately 1,8 Mio tonnes, were supplied by British refineries, which processed raw sugar imported largely from former colonies, and companies in this sector wished to continue to do so after accession.

2.11. During the same period there was a sugar shortage. At the end of a succession of marketing years (beginning in 1971), during which world sugar production was lower than consumption, end-of-year stocks were considerably lower than their usual level (approximately 30 % of consumption, which came down to 20 % in 1973/1974). The market reacted with a sharp price increase, which reached five times its normal level in November 1974. The upward trend was given a further twist by the United States' policy of purchasing on the world market. At that time, the USA imported 5 to 6 Mio tonnes of sugar per year and had no intention of reducing consumption merely on account of high prices. As a result, the exporting countries sold to the highest bidders, so that part of the quantity that was to be supplied to the United Kingdom in accordance with the 'Commonwealth Agreement' was not delivered. There ensued a shortage on the European market which had to be made up for at the very high prices then prevailing on the open market.

2.12. The revision of the sugar scheme in 1975 was greatly affected by the supply crisis mentioned in 2.11, which was, in fact, exceptionally severe (see the graph for the world sugar price in *Table 9*). The experts, however, are well aware that the world market is prone to brief crises at regular intervals. The initial Commission proposal took account of the fact that the Commonwealth imports would be continued in the form of preferential imports in accordance with a protocol established for this purpose within the framework of the Lomé Convention. With the exception of Australia, the former suppliers were authorized to make physical deliveries, in their capacity as ACP countries, of quantities of low-grade sugar to British refineries up to a limit of about 1,3 Mio tonnes of white sugar equivalent per year.

2.13. Moreover, the Commission, in its memorandum of July 1973 and in its proposal of July 1974, respectively, abandoned the idea of scrapping the quota system, which had however been originally intended. It wanted to make use of it in order to bring production under control — in particular, in the context of an international agreement on sugar that was then being negotiated. The memorandum of July 1973 was particularly restrictive: it allowed for an A quota of 8,4 Mio tonnes (equal to internal consumption of 9,8 Mio tonnes minus 1,4 Mio tonnes of import commitments), a B quota equal to 15 % of the A quota and abolition of the right to produce C sugar. In this way the Community would have become a net importer of

600 000 tonnes of sugar. The proposal submitted by the Commission in July 1974 was more favourable to producers. It allowed for an A quota of 8,54 Mio tonnes, a B quota equal to 25 % of the A quota and limits on the production of C sugar only in the event of a surplus on the world market, along with compulsory direction of production to supply domestic needs in the event of a shortage.

2.14. The world market crisis, failure to deliver sugar by certain Commonwealth countries, the effective defence of its interests that was put up by the European sugar industry and over-optimistic estimates of consumer trends by certain experts [1] had the effect of overturning these initial proposals. The new scheme decided upon by the Council was the opposite of the Commission's proposal: an A quota of over 9 Mio tonnes, together with a B quota of 45 %, without any statutory limitation on the quantity of sugar that could be produced outside the quota. The distribution of quotas between the Member States was made on the basis of their production between 1968 and 1973. Considering the large overall increase (+ 17 %), none of the Member States suffered a net loss. At the same time, the target price, which had just been raised by 12,3 % in 1974 in order to take account of the rise in energy costs, was increased by 15 %, which resulted in an overall increase in the price level of 29 %. Lastly, it was decided that ACP sugar imports would have the benefit of the Community institutional price, delivery expenses being charged to the exporters.

2.15. At the same time as the problem of traditional imports of raw cane sugar into the United Kingdom had been settled by means of the award of preferential Community import quotas to ACP countries, an additional quantity was included in the beet sugar production awarded to Denmark, to ensure that the latter continued to supply, as of tradition, the Norwegian market. Prior to its accession to the Common Market, Denmark in fact supplied Norway with approximately 50 000 t of sugar per year. Since it had been expected that Norway would also join the Common Market, provision was made during the negotiations on accession that Denmark would continue to supply this quantity to Norway. The Danish quota was thus fixed accordingly, which meant, for the Danish sugar industry, that these deliveries, which had always been made at prices that were roughly comparable to world prices, would from then onwards be made at the Community guarantee price. When, following the referendum, Norway did not after all join the Community, the Danish quota was not corrected to reflect this new situation and Danish exports to the non-Member State that Norway had become were able to benefit from export refunds, thus giving the Danish sugar industry an advantage corresponding to the difference between the world price and the guaranteed Community price (see paragraph 3.3) on the 50 000 tonnes in question.

**The third sugar regulation and the second enlargement (1981-1986)**

2.16. In 1979, the Commission again put forward restrictive proposals with a view to revising the scheme, which was planned for 1980. These proposals fell within the context of the reform of the Common Agricultural Policy, and aimed to reduce surpluses of Community agricultural production. The Commission proposed one final renewal of the quota system, for a period strictly limited to the following five marketing years, and, at the same time a reduction of the maximum quota by 11 %. This represented an amount of production which exceeded consumption by 9 %, not counting the preferential imports, which represented 14 % of consumption. These two figures together indicated a structurally planned surplus of 23 %. At the same time, a redistribution of quotas between Member States was proposed, to be carried out on the basis of their reference production, including a redistribution of B quotas, which would concern approximately 20 % of the A quota for the whole Community, but would vary, depending upon the Member State, between 0 and 25 %. Meanwhile, isoglucose production had also been included in the quota system, but since the maximum quantity guaranteed had been established definitively at the starting level for this industry, as regards the question of financing the disposal of sugar surpluses, it was proposed to place a ceiling on the B sugar production levy at a rate of 40 % of the intervention price. Moreover, it was intended to use 10 % of the quotas initially granted for the purpose of restructuring the market by redistributing this reserve quantity between undertakings (see paragraph 1.15) (this was to be managed by the Commission), to abolish the quantitative limit on the carry-over of C sugar to the following marketing year and to allow the quantities carried over the benefit of the storage allowance, to authorize the granting of national subsidies in Italy and France (for the ODCT) and finally to abolish the practice of regionalized prices for areas in deficit.

2.17. The above-mentioned proposals provoked so heated a debate that it was not possible to introduce the new scheme in 1980: all that could be done, initially, was to extend the arrangements in force under the existing scheme. Subsequently, discussions again coincided with a shortage, together with high prices on the world market, with the result that between April 1980 and March 1981 the Community was able to sell its sugar surpluses at higher prices than the official Community price, thereby receiving export levies, which compensated for a part of the former disposal expenditure.

[1] Contribution by an FAO expert at the international sugar conference in London in 1975. This expert predicted an increase in sugar consumption in the countries with market-based economies of 25 million tonnes between 1975 and 1985 (starting from a level of about 60 Mio tonnes' consumption in 1973 in the same part of the world).

2.18. This being the situation, the Council finally adopted a new Regulation in April 1981. The latter also covered Greece, a new Member State, which was granted a maximum quota equivalent to its own consumption, which also corresponded roughly to the level of its production in previous years.

2.19. In general, the new regulation provided for a consolidation of the A quotas and a redistribution of the B quotas, implying increases and reductions at national level but bringing the average down to 23,5 % of the basic quota compared with the previous average of 27,5 %. The only exception of note was Italy, which not only retained its existing maximum quota but also had the benefit of the conversion of not less than 90 000 tonnes of its B quota into an A quota. Otherwise, the new B quotas were calculated on the basis of the actual production of B sugar, with a floor equal to 10 % of the A quota. Total B quotas were reduced by 12 % and the overall maximum quota by 1,8 %. The main innovation of the 1981 Regulation was the introduction of the principle that producers should bear the full cost of the disposal of their excess production. To this end, the production levy was extended to include A sugar, with a percentage of 2 %, and the 30 % B levy already existing was increased by this 2 %, plus a supplementary 7,5 % as from 1982/1985, making a total of 39,5 %. In addition, provision was made for it no longer to be compulsory to store C sugar, and for the national aid granted to Italy to be differentiated by region and completed by an authorization to grant aid to alleviate the financial costs of storage. A reserve quantity was introduced into the legislation, but it was not conceived of as a Community redistribution instrument: the 10 % was to be distributed by each of the Member States with, moreover, the possibility of converting sugar quotas into isoglucose quotas, or vice-versa.

2.20. All in all, the Council rejected the Commission's restrictive proposals three times. On the other hand, the principle of full co-responsibility was indeed introduced in the Regulation, by means of levies to be collected from the producers, but the latter were passed on to the institutional price and thus ultimately borne by the consumers.

**The fourth sugar regulation and the third enlargement (1986-1991)**

2.21. Once again, when the five-year scheme came to an end in 1986, its revision coincided with the enlargement of the Community: the sugar scheme was in fact due to be renewed with effect from 1 July 1986 and Spain and Portugal joined the Common Market as from 1 January 1986.

2.22. Spain, which produced more or less as much as it consumed, but at a very high institutional price on account of economically unfavourable production conditions, was allocated a quota equal to its own consumption, including a minimum B quota of 4 % and an intervention price 15,9 % higher than the common intervention price, which was to be aligned with the latter over a transitional period of seven years. This period also applied to the national aid granted under the Treaty of Accession.

2.23. The Portuguese negotiators pointed to the precedent of British accession and obtained the right for the Portuguese refineries to be able to continue to import raw cane sugar at greatly reduced import levy rates, at least for the seven-year transitional period.

2.24. Besides a small such quota for the autonomous region of the Azores, Portugal also received a beet sugar quota of 60 000 tonnes, so that it could develop cultivation of a crop which was previously unknown in continental Portugal.

2.25. Spain and Portugal obtained higher isoglucose quotas than the rest of the Community since an industry producing this sugar substitute had meanwhile been set up in these countries.

2.26. These provisions, which appear in the Treaties of Accession, were automatically incorporated into the new sugar regulation, which, moreover, renewed the scheme as such, without even redistributing either the A or B quotas. The B quotas were thus in effect institutionalized, or rather, nationalized. The only innovation was the institution of the absorption levy: given that ceilings of 2 and 39,5 % of the intervention price for A and B sugar were placed on the production levies, and that the costs of disposing of surpluses had been so high during the period 1981-1986 that the levy proceeds could not cover them, it was not possible to comply with the principle of full co-responsibility, which had been introduced in the 1981 Regulation. The Council decided that an amount of 400 Mio ECU should be recovered to reduce the accumulated deficit, by means of a linear increase in the levies collected. This ad hoc supplementary levy was called an 'absorption levy' and was to be spread over the duration of the 1986-1991 scheme.

2.27. One year afterwards, when the authorities noticed that a new deficit was beginning to accumulate in respect of the marketing years covered by the new scheme, a special absorption levy was introduced with the aim of achieving a balance, from one year to another and over all the marketing years of the five-year scheme, between expenditure on the disposal of surplus production and the revenue intended to finance that expenditure. The production level was thus maintained, but the budgetary consequences were neutralized by the system of levies and prices.

### The extension of the scheme decided upon in 1991

2.28. The present arrangement has just been renewed. According to Council Regulation No 305/91 of 4 February 1991 (1), the scheme will essentially be renewed for a period of two years, with effect from 1 July 1991. Once again, renewal of the scheme coincided with the enlargement of the Community. During the period of preparation of the revision of the scheme, political events in Eastern Europe led to the unification of Germany in 1990. The former German Democratic Republic's sugar sector was characterized by very low technical yields, obsolete industrial plant and a relatively high level of per capita consumption. At the end of the political negotiations on the conditions for including the former GDR in the common market organization, it was decided to increase the German maximum quota of 847 000 tonnes (2). This increase may be broken down into 647 703 tonnes of A quota and 199 297 tonnes of B quota, i.e. the same proportion as that which existed in the Federal Republic prior to unification.

### General assessment of the evolution of the quota system

2.29. The history of the system of production quotas for sugar shows that it has been used as an instrument designed for satisfying the industrial and national interests that are at stake in this market, rather than as a means of guiding production. Indeed, the system has consolidated the situations existing prior to the creation of the common organization of the market or before the accession of new Member States. Long-term application of this system, which was not originally intended, has created production rights for holders of quotas, both at the level of industrial undertakings and farms and that of Member States. The various adjustments to and extensions of the system have resulted in the preservation and maintenance of vested interests, whether production was efficient or not, and whether it was a case of processing domestic agricultural production or imported raw materials, or even a substitute product similarly based on specific domestic agricultural production (isoglucose), the development of which has not been made possible.

## *Evolution of market supply conditions*

### The supply surplus

2.30. ***Table 3*** shows for the Community, in its successive forms, the evolution of the specific components of supply on the sugar market. It can be seen that the third scheme (1981-1986) holds the supply record, with an average of 154 %, including the absolute record of 173 % for the marketing year 1981/1982. The average for the last ten years amounts to 148 %. These percentages show that the sugar market has the highest surplus of all agricultural markets. In the second part of ***Table 3***, (columns 6 to 13), surplus supply is calculated and analysed according to its origin: quota sugar production (A + B), imports and sugar produced outside the quota (C sugar). By comparing the figures in the first and fourth columns (production and consumption figures, respectively), it may be seen that throughout the existence of the sugar CMO there have been only two years during which the Community was not self-sufficient: in 1973/1974 and 1974/1975, i.e. at the time of the accession of the United Kingdom, a traditional importer of raw sugar. After the 1981 revision this 'shortfall' was more than made good and the Community had a surplus for the remainder of the period. While the surplus may vary depending upon climatic and economic conditions, it results first and foremost from a structural discrepancy between the guarantee production and internal consumption (see column 9 = 11,2 % in the first five years of the first scheme, 11,8 % in the second scheme, 21 % over the 1981/1986 period and 15,8 % since 1986). Other contributory factors are imports, in particular preferential imports (amounting to a practically constant figure of 16 % since 1975) and, lastly, the production of C sugar, which varies significantly, but nearly always represents a considerable and sometimes very large proportion. It should be pointed out that the quantities given for A + B production and ex-quota production, respectively, are quantities adopted after the carry-overs of C (or, in some cases, B) sugar as A sugar for the following marketing year. The figures therefore also reflect the use made of the carry-over mechanism by the producers.

(1) Proposal for a Council (EEC) regulation amending Regulation (EEC) No 1785/81 on the common organisation of the market in sugar, submitted by the Commission, doc. COM(90) 323 of 26.9.1990. This proposal led to Council Regulation (EEC) No 305/91 of 4 February 1991 (OJ No L 37, 9. 2. 1991).

(2) Council Regulation (EEC) No 3577/90 of 4 December 1990 concerning the transitional measures and the adaptations necessary in the agriculture sector following German unification (Annex V — sugar, OJ No L 353, 17. 12. 1990, p. 29).

Table 3 — Extent of supply on the common market in sugar

*(in 000s of tonnes)*

| | | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | Origin of excess: | | | | | |
| Scheme | Year | Total product. | Total imports | Total avail. | E.C. consump. | Extent of supply | Excess of supply | % | (1) A+B Quota | % | (2) Import. | % | (3) C sugar | % |
| 1 | 1968/1969 | 6 817 | 112 | 6 929 | 6 306 | 110 | 623 | 9,9 | 477 | 7,6 | 112 | 1,8 | 34 | 0,5 |
| | 1969/1970 | 7 435 | 118 | 7 553 | 6 410 | 118 | 1 143 | 17,8 | 946 | 14,8 | 118 | 1,8 | 79 | 1,2 |
| | 1970/1971 | 7 055 | 123 | 7 178 | 6 750 | 106 | 428 | 6,3 | 182 | 2,7 | 123 | 1,8 | 123 | 1,8 |
| | 1971/1972 | 8 081 | 106 | 8 187 | 6 325 | 129 | 1 862 | 29,4 | 1 130 | 17,9 | 106 | 1,7 | 626 | 9,9 |
| | 1972/1973 | 7 650 | 105 | 7 755 | 6 541 | 119 | 1 214 | 18,6 | 893 | 13,7 | 105 | 1,6 | 216 | 3,3 |
| | 1973/1974 | 9 516 | 1 560 | 11 076 | 10 414 | 106 | 662 | 6,4 | 0 | 0,0 | 662 | 6,4 | 0 | 0 |
| | 1974/1975 | 8 570 | 1 835 | 10 405 | 9 561 | 109 | 844 | 8,8 | 0 | 0,0 | 844 | 8,8 | 0 | 0 |
| | Average | 7 875 | 566 | 8 440 | 7 472 | 113 | 968 | 13,0 | 518 | 6,9* | 296 | 4,0 | 154 | 2,1 |
| 2 | 1975/1976 | 9 703 | 1 570 | 11 273 | 9 535 | 118 | 1 738 | 18,2 | 71 | 0,7 | 1 570 | 16,5 | 97 | 1,0 |
| | 1976/1977 | 10 003 | 1 575 | 11 578 | 9 036 | 128 | 2 542 | 28,1 | 814 | 9,0 | 1 575 | 17,4 | 153 | 1,7 |
| | 1977/1978 | 11 536 | 1 489 | 13 025 | 9 481 | 137 | 3 544 | 37,4 | 1 262 | 13,3 | 1 489 | 15,7 | 793 | 8,4 |
| | 1978/1979 | 11 774 | 1 414 | 13 188 | 9 544 | 138 | 3 644 | 38,2 | 1 426 | 14,9 | 1 414 | 14,8 | 804 | 8,4 |
| | 1979/1980 | 12 289 | 1 503 | 13 792 | 9 414 | 147 | 4 378 | 46,5 | 1 429 | 15,2 | 1 503 | 16,0 | 1 446 | 15,4 |
| | 1980/1981 | 12 088 | 1 320 | 13 408 | 9 246 | 145 | 4 162 | 45,0 | 1 651 | 17,9 | 1 320 | 14,3 | 1 191 | 12,9 |
| | Average | 11 232 | 1 479 | 12 711 | 9 376 | 136 | 3 335 | 35,6 | 1 109 | 11,8 | 1 479 | 15,8 | 747 | 8,0 |
| 3 | 1981/1982 | 15 028 | 1 532 | 16 560 | 9 597 | 173 | 6 963 | 72,6 | 2 901 | 30,2 | 1 532 | 16,0 | 2 530 | 26,4 |
| | 1982/1983 | 13 942 | 1 493 | 15 435 | 9 474 | 163 | 5 961 | 62,9 | 2 042 | 21,6 | 1 493 | 15,8 | 2 426 | 25,6 |
| | 1983/1984 | 11 003 | 1 543 | 12 546 | 9 314 | 135 | 3 232 | 34,7 | 739 | 7,9 | 1 543 | 16,6 | 950 | 10,2 |
| | 1984/1985 | 12 500 | 1 525 | 14 025 | 9 555 | 147 | 4 470 | 46,8 | 2 165 | 22,7 | 1 525 | 16,0 | 780 | 8,2 |
| | 1985/1986 | 12 720 | 1 469 | 14 189 | 9 391 | 151 | 4 798 | 51,1 | 2 108 | 22,4 | 1 469 | 15,6 | 1 221 | 13,0 |
| | Average | 13 039 | 1 512 | 14 551 | 9 466 | 154 | 5 085 | 53,7 | 1 992 | 21,0 | 1 512 | 16,0 | 1 581 | 16,7 |
| 4 | 1986/1987 | 14 096 | 1 704 | 15 800 | 10 907 | 145 | 4 893 | 44,9 | 1 877 | 17,2 | 1 704 | 15,6 | 1 312 | 12,0 |
| | 1987/1988 | 13 211 | 1 790 | 15 001 | 10 834 | 138 | 4 167 | 38,5 | 1 559 | 14,4 | 1 790 | 16,5 | 818 | 7,6 |
| | Average | 13 654 | 1 747 | 15 401 | 10 871 | 142 | 4 530 | 41,7 | 1 718 | 15,8 | 1 747 | 16,1 | 1 065 | 9,8 |

(*) Given the atypical features of the last two years of this scheme (a crisis in the world sugar market and British accession to the Community) the average of the first five years ought to be taken into consideration: 3 628 000 t. of overproduction outside the quota compared with 32 332 000 t. of consumption over this period, i.e. 11,2 %.

### Security of supply

2.31. It may be asked where the error lies in the planning of production, disregarding this institutional context. In other words, when the Community sugar beet growers make their decisions, on the basis of contracts with the sugar manufacturers, to sow a part of their land, how much surplus do they all together sow? To put it another way, by how much would it be possible to reduce the amount of land sown with cereals in the Community without endangering the security of market supply?

2.32. Three factors should be taken into consideration in this respect:

a) the legislation governing preferential imports provokes a preliminary question: do these imports form part of the structural supply of the market or not? First of all, they have been agreed upon within the context of the Lomé Convention since 1975; moreover, the provisions of this protocol provide for sanctions in respect of supplying countries which do not deliver their quota (redistribution of the latter amongst the other contracting parties), so that the shortcomings which arose in 1974 will not occur again so easily; finally, these imports are in fact treated as equivalent to European production as far as price conditions are concerned. They may therefore be considered to be a structural element in supplying this market. This conclusion does not prejudice the economic assessment of this arrangement, which will be discussed later. The Portuguese imports are not considered to be a structural element of the market, insofar as they are defined less precisely and appear as a temporary measure in the Accession Treaty. The ACP imports are therefore treated within the context of the Lomé Conventions;

b) climatic risks, which have a considerable influence on the volume of production, should also be taken into consideration;

c) account should also be taken of a constant increase in yield due to progress in bio-technology and industrial technology.

2.33. Bearing in mind the statistical data for the last 20 years, it would appear realistic to take as a basis a safety margin of 8 %, in order to take account of the climatic factor, coupled with a constant increase in yield of 1,5 % per year. ***Table 4***, which compares production achieved by the application of the actual annual yields by area calculated on the basis of the actual consumption for the same year, shows that sowing could in any case be reduced by 20 % without endangering security of supply. The application of these rules would even result in an almost permanent production surplus, and the few shortfalls that arose could be made good by carry-over and strategic stocks.

## *The rational development of production, the distribution of quotas and the attitude taken by the trade*

### The concept of specialization

2.34. One of the objectives of the Common Agricultural Policy — indeed, the first objective mentioned under Article 39 of the EEC Treaty — is to increase agricultural productivity, by, amongst other things, ensuring the rational development of production. This corresponds to the idea that in a Community, all the Member States together will benefit from an organization of production which directs the various productive activities towards the most efficient areas, and in particular towards those areas that are most suited for a given crop. Thus, in Europe, crops which specifically need light and heat would be best located in the South, whereas those which are more dependant on humidity should be cultivated in the North. This regional specialization allows considerable savings to be made for the whole of agricultural production, insofar as each area concentrates on those activities which it does best and gives up its less efficient production activities.

### Application to sugar beet cultivation and the creation of specialization quotas

2.35. The sugar beet is a plant that requires a humid climate, exposure to the sun and a very fertile soil. It is therefore considered to be a typical Northern European crop or, more precisely, typical of the areas north of the Loire. The best technical yields (expressed globally in tonnes of white sugar per hectare, or in its constituent parts, tonnes of beet per hectare, sugar content and degree of extraction) are therefore to be found in France, the Netherlands and in Belgium, followed by the United Kingdom and the Federal Republic of Germany. Certain areas of Southern Europe may, however, fulfil the conditions required for reasonably efficient production at the technical level. This is true of Greece, for example.

**Table 4 — Analysis of the surface area sown with sugar beet needed in order to guarantee security of supply**

| Years | Actual surface (1) | Actual yield (2) | Trend of yield (3) | Trend of consumption (4) | Surface area needed (5) | Sowing coefficient (6) | Supply mismatch (7) |
|---|---|---|---|---|---|---|---|
| 1968/1969 | 1 582 | 5,32 | 5,30 | 10 700 | 2 180 | 0,73 | 10,57 |
| 1969/1970 | 1 578 | 5,73 | 5,38 | 10 700 | 2 148 | 0,73 | 15,15 |
| 1970/1971 | 1 601 | 5,49 | 5,46 | 10 798 | 2 136 | 0,75 | 5,87 |
| 1971/1972 | 1 621 | 6,40 | 5,54 | 10 995 | 2 143 | 0,76 | 27,92 |
| 1972/1973 | 1 660 | 5,68 | 5,62 | 11 000 | 2 114 | 0,79 | 9,01 |
| 1973/1974 | 1 777 | 5,64 | 5,70 | 10 724 | 2 032 | 0,87 | −0,10 |
| 1974/1975 | 1 758 | 5,06 | 5,79 | 10 439 | 1 947 | 0,90 | −8,07 |
| 1975/1976 | 2 163 | 4,85 | 5,88 | 10 185 | 1 871 | 1,16 | −6,40 |
| 1976/1977 | 2 210 | 5,10 | 5,97 | 9 875 | 1 786 | 1,24 | −1,99 |
| 1977/1978 | 2 057 | 6,11 | 6,06 | 9 701 | 1 729 | 1,19 | 8,36 |
| 1978/1979 | 2 032 | 6,27 | 6,15 | 9 722 | 1 707 | 1,19 | 7,89 |
| 1979/1980 | 1 964 | 6,55 | 6,24 | 9 790 | 1 694 | 1,16 | 12,69 |
| 1980/1981 | 1 989 | 6,46 | 6,33 | 9 747 | 1 663 | 1,20 | 9,61 |
| 1981/1982 | 2 247 | 7,00 | 6,42 | 9 630 | 1 620 | 1,39 | 17,72 |
| 1982/1983 | 2 100 | 7,03 | 6,52 | 9 543 | 1 581 | 1,33 | 16,59 |
| 1983/1984 | 1 913 | 6,25 | 6,62 | 9 458 | 1 543 | 1,24 | 3,30 |
| 1984/1985 | 1 938 | 6,84 | 6,72 | 9 457 | 1 520 | 1,28 | 10,45 |
| 1985/1986 | 1 886 | 7,05 | 6,82 | 9 461 | 1 498 | 1,26 | 12,65 |
| 1986/1987 | 1 893 | 7,27 | 6,92 | 9 500 | 1 483 | 1,28 | 11,97 |
| 1987/1988 | 1 854 | 6,94 | 7,02 | 9 500 | 1 462 | 1,27 | 6,20 |

(1) In thousands of hectares.
(2) In tonnes of white sugar per hectare.
(3) In tonnes of white sugar per hectare, on the assumption of a constant annual increase of 1,5 %.
(4) In thousands of tonnes: 1973/1974 consumption adjusted by −500 000 t.
(5) Surface area needed allowing for a risk of an 8 % variation in the yield, in 000s of ha.
(6) (1)/(5).
(7) In %, as a proportion of actual consumption.

2.36. In the first sugar regulations (see paragraph 1.12 of this report), the B quotas were meant to be specialization quotas. The quantities produced under this quota were subject to the co-responsibility levies with the dual objective of guiding production towards those areas where it would still be profitable at a lower price and of financing at the same time the cost of disposing of the surplus. The initial idea was clearly one of 'migratory quotas', the practical implementation of which would move to those regions where it could be carried out in the most favourable conditions.

### The actual distribution of quotas

2.37. As has been shown above (see paragraph 2.29), production quotas have turned into real, individualized rights. If account is taken, moreover, of the fact that the institutional prices are fixed at a generous level by the Community authorities, it is clear that the specialization mechanism planned for in theory has obviously lacked selectivity in reality. The wish of the parties directly concerned, and of the national political authorities, to obtain and conserve the highest possible quotas stems understandably from a concern to safeguard the considerable investments they have made in this area and from the idea that such a basic consumer need should be satisfied at all times. Over the years, during the successive revisions of the scheme, a situation has gradually come about where the stabilization of A quotas per Member State was followed by a comparable 'nationalization' of the B quotas, as shown in *Table 5*. This trend has resulted in the common market in sugar having a totally compartmentalized structure, like a collection of national markets. The A+B quotas are completely immovable as between the Member States, and even, within the majority of the latter, as between undertakings. This situation of total immobility is preventing production from reaching its economically optimum position at Community level.

Table 5 — The geographical distribution of B quotas over the years

| | B | | DK | | D | | GR | | E | | F | | IRL | | I | | NL | | P | | UK | | CE | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | A | B | A | B | A | B | A | B | A | B | A | B | A | B | A | B | A | B | A | B | A | B | A | B |
| 1968/1969 | 550 | 92 | | | 1 750 | 613 | | | | | 2 400 | 840 | | | 1 230 | 431 | 550 | 92 | | | | | 6 480 | 2 068 |
| 1969/1970 | 550 | 92 | | | 1 750 | 613 | | | | | 2 400 | 840 | | | 1 230 | 431 | 550 | 92 | | | | | 6 480 | 2 068 |
| 1970/1971 | 550 | 92 | | | 1 750 | 613 | | | | | 2 400 | 840 | | | 1 230 | 431 | 550 | 92 | | | | | 6 480 | 2 068 |
| 1971/1972 | 550 | 83 | | | 1 750 | 613 | | | | | 2 400 | 840 | | | 1 230 | 431 | 550 | 83 | | | | | 6 480 | 2 050 |
| 1972/1973 | 550 | 83 | 290 | 102 | 1 750 | 613 | | | | | 2 400 | 840 | 150 | 53 | 1 230 | 431 | 550 | 83 | | | 900 | 0 | 7 820 | 2 205 |
| 1973/1974 | 550 | 83 | 290 | 102 | 1 750 | 613 | | | | | 2 400 | 840 | 150 | 53 | 1 230 | 431 | 550 | 83 | | | 900 | 0 | 7 820 | 2 205 |
| 1974/1975 | 550 | 110 | 290 | 131 | 1 750 | 788 | | | | | 2 400 | 1 080 | 150 | 68 | 1 230 | 554 | 550 | 110 | | | 900 | 90 | 7 820 | 2 931 |
| 1975/1976 | 680 | 306 | 328 | 148 | 1 990 | 896 | | | | | 2 996 | 1 349 | 182 | 82 | 1 230 | 554 | 690 | 311 | | | 1 040 | 468 | 9 136 | 4 114 |
| 1976/1977 | 680 | 119 | 328 | 115 | 1 990 | 696 | | | | | 2 996 | 1 049 | 182 | 64 | 1 230 | 431 | 690 | 121 | | | 1 040 | 364 | 9 136 | 2 959 |
| 1977/1978 | 680 | 119 | 328 | 115 | 1 990 | 696 | | | | | 2 996 | 1 049 | 182 | 64 | 1 230 | 431 | 690 | 121 | | | 1 040 | 364 | 9 136 | 2 959 |
| 1978/1979 | 680 | 94 | 328 | 90 | 1 990 | 547 | | | | | 2 996 | 824 | 182 | 50 | 1 230 | 338 | 690 | 190 | | | 1 040 | 286 | 9 136 | 2 419 |
| 1979/1980 | 680 | 94 | 328 | 90 | 1 990 | 547 | | | | | 2 996 | 824 | 182 | 50 | 1 230 | 338 | 690 | 190 | | | 1 040 | 286 | 9 136 | 2 419 |
| 1980/1981 | 680 | 187 | 328 | 90 | 1 990 | 547 | 249 | 68 | | | 2 996 | 824 | 182 | 50 | 1 320 | 338 | 690 | 190 | | | 1 040 | 286 | 9 475 | 2 580 |
| 1981/1982 | 680 | 146 | 328 | 97 | 1 990 | 612 | 290 | 29 | | | 2 996 | 806 | 182 | 18 | 1 320 | 248 | 690 | 182 | | | 1 040 | 104 | 9 516 | 2 242 |
| 1982/1983 | 680 | 146 | 328 | 97 | 1 990 | 612 | 290 | 29 | | | 2 996 | 806 | 182 | 18 | 1 320 | 248 | 690 | 182 | | | 1 040 | 104 | 9 516 | 2 242 |
| 1983/1984 | 680 | 146 | 328 | 97 | 1 990 | 612 | 290 | 29 | | | 2 996 | 806 | 182 | 18 | 1 320 | 248 | 690 | 182 | | | 1 040 | 104 | 9 516 | 2 242 |
| 1984/1985 | 680 | 146 | 328 | 97 | 1 990 | 612 | 290 | 29 | | | 2 996 | 806 | 182 | 18 | 1 320 | 248 | 690 | 182 | | | 1 040 | 104 | 9 516 | 2 242 |
| 1985/1986 | 680 | 146 | 328 | 97 | 1 990 | 612 | 290 | 29 | | | 2 996 | 806 | 182 | 18 | 1 320 | 248 | 690 | 182 | | | 1 040 | 104 | 9 516 | 2 242 |
| 1986/1987 | 680 | 146 | 328 | 97 | 1 990 | 612 | 290 | 29 | 960 | 40 | 2 996 | 806 | 182 | 18 | 1 320 | 248 | 690 | 182 | 55 | 1 | 1 040 | 104 | 10 531 | 2 283 |
| 1987/1988 | 680 | 146 | 328 | 97 | 1 990 | 612 | 290 | 29 | 960 | 40 | 2 996 | 806 | 182 | 18 | 1 320 | 248 | 690 | 182 | 55 | 1 | 1 040 | 104 | 10 531 | 2 283 |
| 1988/1989 | 680 | 146 | 328 | 97 | 1 990 | 612 | 290 | 29 | 960 | 40 | 2 996 | 806 | 182 | 18 | 1 320 | 248 | 690 | 182 | 55 | 1 | 1 040 | 104 | 10 531 | 2 283 |
| 1989/1990 | 680 | 146 | 328 | 97 | 1 990 | 612 | 290 | 29 | 960 | 40 | 2 996 | 806 | 182 | 18 | 1 320 | 248 | 690 | 182 | 55 | 1 | 1 040 | 104 | 10 531 | 2 283 |
| 1990/1991 | 680 | 146 | 328 | 97 | 1 990 | 612 | 290 | 29 | 960 | 40 | 2 996 | 806 | 182 | 18 | 1 320 | 248 | 690 | 182 | 55 | 1 | 1 040 | 104 | 10 531 | 2 283 |

### The 'nationalization' of quotas

2.38. The compartmentalization of the market has consequences that run counter to the initial spirit of the Community legislation. Thus, a good example of the national conception of the organization of this market may be seen in the protests of certain Member States who complain of the fact that the ratio between their A quota and their B quota does not correspond to the ratio between their national consumption and their exports, this latter representing a smaller share of their production than their B quota. They therefore consider that they are financing the export costs of the other States through their B levies. If we push this logic to its limit, the process of nationalization of sugar policy would be complete if the Community stopped collecting production levies to finance exports and left the job of financing the cost of exporting the share of production exceeding national consumption to the Member States themselves. There would then no longer be any kind of common market.

## *The other general provisions affecting economic effectiveness*

### Mixed prices

2.39. The basic regulation lays down that minimum prices should be fixed each year for A beet, as for B beet. These minimum prices are calculated on the basis of the basic price for beet, by applying coefficients fixed, in principle, at 98 % and 68 % respectively. The basic price is in turn derived from the intervention price for white sugar. In the contracts between the beet-growers and the factories for the delivery of beet, a distinction should in principle be made between the quantities of beet intended for the production of A sugar, B sugar or sugar other than A or B.

2.40. However, an inter-trade agreement may, with the approval of the Member State, derogate from this obligation. Such a derogation may, in practice, result in the application of a single price to the entire quantity of beet provided for by the contract. In that case the beet-grower receives the same price, the so-called 'mixed price', for its A and B beet and the distinction between the two disappears and, with it, the option of deciding whether or not to produce specialization quantities. Of course, in situations where the price of B beet would in any case have been a sufficient incentive, it would not have made any difference. In the case of economically marginal farms, however, this practice may lead to the production of B beet that otherwise would not have been produced.

2.41. Such is a fortiori the case if the possibility of including a quantity of C beet is explicitly (for example, in the form of a percentage) or implicitly (by reference to the area sown or the quantity of beet) provided for in the contract, or if a sliding-scale price schedule is applied to production beyond the basic quantity. This system of mixed prices is convenient both for the manufacturers and for the growers, insofar as the cost for the former or the income for the latter remains the same for each unit delivered within the limit of the contractual estimate, and in that it protects growers from awkward questions about the relative profitability of one or the other constituent part of this production.

2.42. Nevertheless, it does encourage additional production in the case of economically marginal farms, and above all in cases where a C constituent part has been included. That was the reason why the first sugar regulations provided for an automatic reduction in the B quota for countries applying the system of mixed prices. At that time, only Belgium and the Netherlands applied a mixed price. Since the waiver of the automatic reduction rule in 1981, practically all the countries concerned (except for Denmark, Germany and France) applied mixed prices for beet, several of which included a section for C sugar.

2.43. Even if it is difficult to quantify this mechanism's impact on production, it is obvious that it constitutes a factor which runs counter to the principle of specialization. Insofar as the mixed price for beet conceals the element of differentiation between the three levels of guarantee price represented by categories A, B and C, it reduces the dissuasive effect that the differentiated price schedule is supposed to have on less efficient producers. It results in sugar being produced which, in accordance with Community economic logic, should, for economic reasons, not be produced.

### Regionalized prices

2.44. Since the setting-up of the common organization of the market in sugar, the legislation has provided for a geographical differentiation of the intervention price (see paragraph 1.16). For those areas considered as having a sugar deficit, a so-called 'derived' price is fixed, representing the common intervention price plus 1,21 ECU/100kg (for Ireland and the United Kingdom) or 1,94 ECU/100 kg (for Italy), if the intervention price of 53,01 ECU/100 kg, which is applicable during the 1990/1991 marketing year, is used as a basis. A separate derived price is also fixed for the French ODTs. The initial objective of this regionalization of the intervention price was to encourage a trade flow that would bring sugar from the surplus areas to the deficit areas. Consequently, the amounts of the price increases were supposed to reflect the cost of transport from one to the other. In fact, if the figures for national production and consumption are compared today, the countries in question are no longer (Ireland) or hardly ever

(Italy) in deficit, or are only in deficit if no account is taken of the structural satisfaction of a part of demand (United Kingdom) by preferential imports (see *Table 6*). Ultimately therefore, this price supplement has had the effect, by distorting the cost-benefit ratio, of promoting production in areas where it is economically less viable.

### National aid

2.45. While the first basic regulation considered that the attainment of a single market based on a common price system would be jeopardized by the granting of certain forms of aid and that it was therefore necessary to prohibit all forms of aid that were incompatible with the common market, it provided for an authorization, exceptionally and on a temporary basis, of national aid in Italy. It was expressly stipulated in the regulation itself that these subsidies would be abolished on 30 June 1975, and therefore at the end of the first scheme. Nevertheless, the second regulation merely repeated the recital set out in this connection in the first regulation, in particular as regards the temporary granting by Italy of national aid, which from that time on was known as 'adaptation subsidies'. Pursuant to this regulation, the authorization applied to the marketing years 1975/1976 to 1979/1980.

2.46. The 1981 Regulation, which defines the third scheme, lays down that national aid should be permitted, adding the case of the French ODTs to that of Italy, and interest-cost subsidies related to storage to the existing Italian adaptation subsidies. When the scheme was renewed in 1986, which mainly involved an extension of the existing arrangements, this provision was maintained, and even extended to include national aid awarded to the United Kingdom for the refining of sugar cane, together with a Community contribution of 25 %. Moreover, in the Treaty of Accession, provision was made for Spain to grant national adaptation subsidies to beet-growers during the period from 1 January 1986 to 31 December 1995. The national subsidies granted in respect of the French ODTs are currently considered to be part of a wider programme of aid for regional restructuring and it is planned to transfer them from the sugar legislation to the Poseidom set of regulations.

2.47. It is impossible not to conclude from all the above that, on the one hand, the practice of national subsidies, which was originally a temporary exception, has been perpetuated, and that, on the other hand, such practices have tended to multiply as new Member States have joined the Community. What started out as nothing more than a temporary exemption, designed to allow the areas concerned to catch up, has, with time, become a structural element of the scheme. In this way the sugar industry is being kept artificially viable in certain areas, which will be illustrated in more detail in the following paragraphs. The prevailing situation is therefore no longer one of progressive adaptation to the operations of the market, which was the initial objective of the authors of the Community legislation, but is rather an obstacle to a more rational operation of the sugar market at Community level.

### Call for sugar-beet quotas

2.48. Following the recent trends towards concentration and internationalization in the sugar industry, certain beet-growers are afraid that sugar production will disappear from their regions. In view of the geographical link between the production of the raw material and the processing plant, this involves a risk for them of losing their livelihoods as beet-growers. In order to avoid such a development, they recommend replacing the sugar quotas with beet quotas, at the level of the market regulation. Since these are, more especially, cases of production in areas less suited to this crop, such a way of thwarting any relocation of production factors would obviously tend to keep the less efficient producers in business.

## *Specific problems in some Member States*

### Restructuring in Italy

2.49. The Italian sugar sector benefits from three special measures which have been mentioned already, namely: a 3,5 % increase in the intervention price under the regional pricing system; national aid to make up the difference between the true rate of interest and the flat rate included in the statutory storage compensation in cases where the difference is more than 3 %; and national conversion aid. In the case of the latter, the basic regulation that is currently in force provides that the maximum amount of aid shall be 23,64 % of the intervention price for white sugar. The level of aid is being reduced, however, by one tenth per annum with effect from the 1988/89 season. The aid is granted in the form of a production subsidy. Under the current system, 73 % of this amount is passed on to the beet growers and the remaining 27 % is paid to the industry.

2.50. The conversion aid was authorized by a series of regulations because climatic conditions in Italy were not suitable for beet and sugar production and there were problems with applying modern production methods to a form of beet production which has not kept pace with technological developments. In fact, the amount of aid

**Table 6 — Rate of supply of countries considered to be in a deficit situation as regards sugar**

*(in 000s of tonnes)*

| | | 1981/1982 | 1982/1983 | 1983/1984 | 1984/1985 | 1985/1986 | 1986/1987 | 1987/1988 | 1988/1989 | Average |
|---|---|---|---|---|---|---|---|---|---|---|
| Ireland | Production | 168 | 222 | 197 | 222 | 174 | 186 | 222 | 196 | 198 |
| | Consumption | 143 | 137 | 144 | 137 | 135 | 144 | 115 | 123 | 135 |
| | prod./cons. | 1.17 | 1.62 | 1.37 | 1.62 | 1.29 | 1.29 | 1.93 | 1.59 | 1.47 |
| | Consumption (including supplies *in* Northern Ireland) | 164 | 162 | 166 | 161 | 163 | 166 | 140 | 145 | 158 |
| | prod./cons. | 1.02 | 1.37 | 1.19 | 1.38 | 1.07 | 1.12 | 1.59 | 1.35 | 1.25 |
| Italy | Production | 2 048 | 1 180 | 1 244 | 1 274 | 1 244 | 1 719 | 1 718 | 1 481 | 1 488 |
| | Consumption | 1 505 | 1 520 | 1 493 | 1 641 | 1 546 | 1 581 | 1 491 | 1 495 | 1 534 |
| | prod./cons. | 1.36 | 0.78 | 0.83 | 0.78 | 0.81 | 1.09 | 1.15 | 0.99 | 0.97 |
| United Kingdom | Production (1) | 1 092 | 1 418 | 1 062 | 1 314 | 1 210 | 1 318 | 1 226 | 1 308 | 1 243 |
| | Consumption | 1 172 | 1 189 | 1 133 | 1 126 | 1 109 | 1 163 | 1 149 | 1 204 | 1 156 |
| | prod./cons. | 0.93 | 1.19 | 0.93 | 1.16 | 1.09 | 1.13 | 1.07 | 1.09 | 1.07 |

(1) Minus imports of preferential sugar.

which was authorized initially was intended to make up the difference between the institutional prices applied before and after the establishment of the common market in sugar (this is why, in 1968, the guaranteed price in Italy was 50 % higher than the guaranteed price for France).

2.51. In 1983 there was a general recession in the Italian sugar sector. In view of the relative advantages of alternative crops, the Italian government implemented a restructuring plan which was to be financed from the national budget with the aim of reorganizing the sector and making it more competitive. One of its main objectives was to reduce the number of factories whilst increasing the capacity of the remaining plants and thus improving their economic efficiency. This plan was implemented in the period 1984-1988. The main objective of the operation, namely to reach an average processing capacity of 60 000 tonnes per factory per season (on average, the season lasts for 64 days), was not achieved. Furthermore, as the industrial aspect is an important feature of the sugar industry, the plan was also affected by the national industrial policy guidelines, which specified a particular geographical distribution for the plants. In this way the treatment accorded to the Italian sugar industry, which was already in a special position compared with other areas of the Community, was also differentiated within the country. More particularly, the price thus increased by the various components was differentiated by region: North, Central or South. The guaranteed price is in fact highest in the South, the region least suited to this type of crop, and lowest in the North, the area which is most suitable, with the Central area lying between the two. Whereas the average yield for the whole of Italy is 5,7 tonnes of white sugar per hectare (compared with 7,0 Community-wide), it is 6,1 t/ha in the North, 5,1 t/ha in the Central region and 4,5 t/ha in the South. The breakdown for total production is 70 % in the North, 15 % in the Central area and 15 % in the South.

2.52. The regulatory maximum for the conversion aid to Italy (23,64 % of the intervention price for white sugar) was finally reduced to 90 % of the initial limit for the 1989-1990 season and 80 % for the 1990-1991 season. In its proposals for the revision of the system for the 1991-1992 and 1992-1993 seasons ([1]), the Commission suggested that the aid should continue to be reduced gradually and that the ceilings should be set at 70 % and 60 % respectively of the initial amount of the exemption granted for the 1988-1989 season. Council Regulation No EEC/305/91 of 4 February 1991 has finally opted for a ceiling of 70 % for the two years in question.

2.53. Despite the limited success of the national plan for restructuring the beet and sugar sector, the Italian authorities are at present launching a second five-year programme, more or less on the same lines as the first. In view of the fact that, despite all its efforts, Italy is still one of the least efficient sugar-producing countries in terms of production costs, the question arises as to whether such guidelines should be perpetuated, given that they are seemingly contrary to the principle of rational expansion of production and also, to a certain extent, affect the Community's finances. In particular, it must be asked whether the consolidation and reorganizational aspects of the restructuring ought, perhaps, to be targeted on the percentage of production, which is fairly small in terms of present levels, that could be economically viable in the Community context.

**The transitional arrangements for Spain**

2.54. The situation in the Spanish sugar market at the time of Spain's accession to the Community in 1986 was, in some ways, similar to that which existed in Italy when the common market in sugar was established in 1968. Spain is a south European country and therefore unsuited to sugar-beet production. Structures on the farms where beet is grown are old-fashioned and the level of modernity in the processing industry is variable. The global average yield is 5,3 tonnes of white sugar per hectare, significantly lower than the European average (7,0). In most of the country multigerm seed is used, requiring very intensive use of manpower to thin out the seedlings in the beet fields. (In other countries this factor is markedly less important, due to the use of monogerm seed).

2.55. Before Spain joined the Community, the official Spanish price was almost 16 % higher than the official Community price. The Treaty of Accession granted Spain an intervention price plus the above difference. The difference was to be phased out over a transitional period of seven years by means of a total price freeze, on the assumption that the Community intervention price would increase, as was normal at that time. There is, however, provision for the transitional period to be extended by a further three years should any difference still remain at the end of the initial period. This possibility cannot be ruled out, as the Community intervention price is no longer increasing year by year at the same rate as it did prior to 1986.

2.56. In addition, the Treaty of Accession authorized substantial grants of aid for the conversion of agricultural holdings, subject to a ceiling of 23,64 % of the beet base price. This exemption applies until 31 December 1995. Finally, Spain was given a quota for A and B sugar which was slightly in excess of domestic consumption. In view of the Italian example, the Community authorities could take care to prevent a similar tendency occurring in Spain, as it could pose something of an obstacle to the optimum development of the sugar market.

([1]) Proposal for a Council (EEC) regulation amending Regulation (EEC) No 1785/81 on the common organisation of the market in sugar, submitted by the Commission, doc. COM(90) 323 of 26.9.1990. This proposal led to Council Regulation (EEC) No 305/91 of 4 February 1991 (OJ No L 37, 9. 2. 1991).

## Supplies to the Portuguese market

2.57. Portugal has traditionally imported raw cane sugar from its former colonies and, more recently, from the world free market, for home refining. The autonomous region of the Azores were self-sufficient in sugar due to a small local beet-growing industry. On accession Portugal invoked the precedent of the United Kingdom in order to claim the right to continue to import raw sugar to supply its refineries. Under the terms of the Treaty of Accession, Portugal is authorized to import the quantities of raw sugar needed to meet its requirements at a reduced import levy rate to the extent that the necessary raw sugar is not available in the Community (around 300 000 tonnes per year).

2.58. The Treaty provisions, which cover a period of seven years from 1 January 1986, provide authorization for the importation of 75 000 tonnes per annum from four specified ACP countries in the first instance. Since supplies of raw sugar of Community origin (mainly from the French overseas departments and a small amount from metropolitan France) are somewhat limited in terms of the demand that has to be met, a substantial amount still has to be bought on the free world market, again at a price that is reduced by the import levy. In so far as this arrangement merely perpetuates the main aspects of the supply situation which existed in the Portuguese market prior to that country's accession, it does not improve the organization of the Community sugar economy in any way.

2.59. Portugal's accession was accompanied by another concession: the allocation of a quota of 60 000 tonnes for beet sugar. This amount was intended to cover the expected increase in national consumption, which in fact is far from having been achieved. Sugar beet has never been grown in continental Portugal, however, and the industry will therefore have to start from scratch with the construction of a processing plant. The only sugar-beet produced in Portugal is in the autonomous region of the Azores, where production has declined in recent years because dairy-farming holds out better prospects for local farmers. Attempts to start beet production in continental Portugal are proving particularly difficult. Current production amounts to only a few thousand tonnes, which are sent to Spain by rail for refining and then freighted back to Portugal. The project for the construction of a plant is temporarily in abeyance while the national authorities study the possibility of using Community structural funds to alleviate the financial burden. All things considered, it is clearly lacking in realism to grant a sugar beet quota to continental Portugal.

## Sugar-beet production in Greece

2.60. Greece's accession to the Community took effect in 1981, coinciding, more or less, with the change of government which took place that year. It was allocated a quota of 319 000 tonnes, which corresponded approximately to the level of national consumption. Although Greece is a Mediterranean country, its performance figures are more akin to those of a typical northern area than to those of the other Mediterranean countries. As can be seen from *Table 7*, Greece is top of the table in terms of tonnes of beet production per hectare and is slightly above the average in terms of sugar yield per hectare, with levels very comparable to those of the FRG and ahead of Denmark and the United Kingdom.

2.61. This situation can be explained by a combination of structural factors on the one hand and the specific organization of this agro-industry on the other. The sugar beet is grown in a number of deltas in the north of the country, which typically have very fertile soils, suitable irrigation infrastructure and a continental-type microclimate. The sugar sector in Greece is a fairly recent innovation and has been organized rationally as part of an agro-industry development programme which was launched in 1960. Both the industrial technology and the farming methods were researched systematically abroad before they were introduced into the country. The sector is characterized by the very close relationship between farmers and the industry in respect of advisory services, seed, fertilizers and pesticides, disease prevention and

**Table 7 — Technical yields in sugar beet and white sugar per ha. (average over the period 1981/82 — 1988/89)**

| | B | DK | D | GR | E | F | IRL | I | NL | UK | EEC |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Yield in tonnes of beet per ha. | 54,6 | 44,1 | 48,9 | 60,1 | 39,1 | 54,1 | 41,9 | 48,8 | 53,5 | 41,6 | 49,0 |
| Position in the ranking | 2 | 7 | 5 | 1 | 10 | 3 | 8 | 6 | 4 | 9 | |
| Yield in tonnes of white sugar per ha. | 7,6 | 6,6 | 7,2 | 7,2 | 5,1 | 8,4 | 5,6 | 5,7 | 7,7 | 6,2 | 7,0 |
| Position in the ranking | 3 | 6 | 4 | 5 | 10 | 1 | 9 | 8 | 2 | 7 | |

mechanization. This highly coordinated approach has made it possible to achieve the performance figures referred to above.

2.62. On the economic side, the real level of performance is more difficult to identify, because the Greek sugar industry is in fact owned by the State through the agency of the national agricultural bank, so that the economic and financial conditions under which the industry operates do not make it possible to establish conclusively whether it is operating profitably. As regards the terms offered to Greek beet farmers, it was found that, in addition to the agronomic and logistical support mentioned above, the price they receive for their beet is 15 % to 20 % higher than the minimum regulation price (fixed as specified in 1.16(f) above). Consequently it is difficult to form any clear opinion as to the true level of economic efficiency of Greek sugar production.

## *The situation with regard to isoglucose*

2.63. The technology of isoglucose manufacture is now so advanced that this substitution product can be obtained from cereals of European origin. When the process was introduced in the 1970s, the basic raw material was still quality maize, which had to be imported from the United States. The process is based on a Japanese invention and was perfected in the United States which at that time was importing 5 million tonnes of sugar, mainly from the countries of Central and South America. The manufacture of isoglucose from maize, which was (and still is) in surplus in the United States, made it possible for the latter to reduce its imports of sugar, where there was a shortfall, from four million tonnes to one million tonnes.

2.64. Isoglucose is used in the manufacture of food products which require a liquid sweetener, such as soft drinks, yoghourt, jam, ice cream, etc. In the United States these products represent between 30 % and 40 % of sweetener consumption. In Europe they represent between 20 % and 30 % of the market, the equivalent of approximately 2,5 million tonnes of sugar. In the United States this market share is effectively held by isoglucose, which makes it possible to avoid imports and to use the maize surpluses profitably. In Europe in the 1970s the situation was exactly the reverse: the Community had a sugar surplus and had to import American quality maize in order to be able to produce isoglucose. Nevertheless, the ratio between the prices of these two commodities made the manufacture of isoglucose profitable even at that time. The technology was later developed to the point where it was possible to base production on other, lower-grade cereals. Nowadays, for example, one of the largest producers, Belgium, uses only Belgian wheat, with costs considerably lower than those for sugar. The choice is therefore reduced to a choice between two commodities of European agricultural origin.

2.65. In 1979, after a number of restrictive measures had been taken, the advocates of protection for the sugar industry succeeded in getting isoglucose incorporated into the common market organization for sugar. A production quota was fixed on the basis of a reference level of production achieved in the preceding years, without taking into account the production capacity represented by the plants which were then under construction. Isoglucose production was thus limited to around 2 % of the global maximum quota (A + B, sugar and isoglucose), which is well below its potential. Isoglucose was also made part of the system of production levies, even though there are practically no exports of this product. When Greece, and then Spain and Portugal, joined the Community, the isoglucose quotas allocated to them were proportionately slightly higher, because the reference production level had been achieved under the pre-Community system. The present distribution of isoglucose quotas, compared with sugar quotas, is shown in *Table 8*.

2.66. It is easy to understand the advantage, for the sugar industry, of keeping the level of isoglucose production as low as possible: the 'sweetening power:production costs' ratio for this product is far more favourable than that of sugar, for which it represents a dangerous competitor. If this is true in the case of Belgium, a country which is eminently suitable for sugar-beet growing and less so for the production of high-grade cereals, how much greater is it in the case of the countries of southern Europe, which are generally less suitable for beet growing, but far more able to produce quality cereals (maize for example). From a macroeconomic standpoint, it might therefore be expected that in the south of Europe cereal-based isoglucose production should be encouraged and that the aim should be to substitute that product for beet sugar, which is economically less profitable.

2.67. In fact, however, the quotas not only did not evolve in this direction but on occasions when the system has been revised, the national authorities have not even made use of their reserve quantities of 10 % of the sugar quotas which they are allowed to convert into isoglucose quotas (see paragraphs 1.15, 2.16 and 2.19) as a way of promoting this type of production. It is an observable fact that the responsible authorities in the countries most suited for developing such a product in fact do nothing to make it possible. In some cases, even, their attitude is the reverse. The Greek government, for example, has effectively blocked for a period of more than two years part of the Greek isoglucose quota which became available following the failure of the undertaking which held it, by refusing

Table 8 — Distribution of sugar and isoglucose quotas (1988/89 year)

| | B | DK | D | GR | E | F | IRL | I | NL | P | UK | EEC |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Maximum sugar quota, in 000s of tonnes of white sugar | 826 | 425 | 2 602 | 319 | 1 000 | 3 802 | 200 | 1 568 | 872 | 70 | 1 144 | 12 828 |
| Maximum isoglucose quotas, in 000s of tonnes of dry raw material | 72 | — | 36 | 13 | 83 | 20 | — | 20 | 9 | 10 | 28 | 291 |
| Maximum isoglucose quota, as a % of maximum sugar quota (1) | 8,7 | — | 1,4 | 4,1 | 8,3 | 0,5 | — | 1,3 | 1,0 | 14,3 | 2,4 | 2,3 |

(1) This is a reference to beet sugar quotas, not to sugar imported under the preference system, which affects the ratios, in particular for Portugal and the United Kingdom.

initially to allocate it to the other Greek isoglucose producer, which has surplus production capacity, and awarding it instead to the Greek sugar producer, which does not have the necessary plant, so that this isoglucose quota has since remained unused. Isoglucose thus typifies the way in which obstacles are wilfully put in the way of rational development of the market.

## *Conclusion*

2.68. The various factors detailed in this chapter illustrate how far we are from the principles of market stabilization and rational development of production set out in Article 39 of the EEC Treaty. Furthermore, the common market principles which are laid down in Article 40 of the same Treaty have in fact been defeated. In this way the system of national quotas has become an end in itself: it creates production rights when there is no real need for the product, resulting in the development of an economically barely viable form of production. This involves clear consequences for consumer prices and the financial equilibrium of the system, that is, ultimately for its proper financial management. Before drawing the consequences, we must examine the external aspects of the system.

# 3. INTERNATIONAL MACRO-ECONOMIC ASPECTS AND THE WORLD SUGAR MARKET

## *The world market*

### Characteristics of the world market

3.1. In recent years world sugar production has amounted to approximately 105 million tonnes of raw sugar. Roughly speaking, three quarters of the sugar produced is consumed in the country of production, leaving some 27 million tonnes to be traded on world markets. Part of this takes place under bilateral preferential trade agreements, between the USSR and Cuba, the United States and South and Central America and between the EEC and the ACP countries, for example. After deduction of this trade, the world free market accounts for approximately 18 million tonnes of raw sugar per year. The world market is split more or less equally between raw sugar and white sugar. The commodity is traded on three exchanges, New York, Paris and London. These are futures markets, which means that the total volume of trades is substantially larger than the actual volume of the commodity that is ultimately delivered.

3.2. As on all free markets, the price is determined by the relationship between supply and demand. A large part of the supply consists of surplus production from the producer countries which operate a protectionist system whereby they supply their own needs and subsidize exports of quantities produced in excess of their own requirements. Of course, some of these exports do not have the benefit of official pricing; but exporters usually consider them profitable because they base their calculations exclusively on the marginal cost.

The market price is thus not the prime factor which determines the volume of such exports. Due to the residual nature of the market, the price may even drop below the level of the production costs of an efficient producer who is supplying the world market. The market is also residual in terms of demand: the producer countries use it to make up any shortfall, which may occasionally create temporary price surges. In consequence, the free world market is very volatile and bears very little relationship to production costs.

3.3. Only a very few exporter countries, such as the ones with the lowest production costs (e.g. Australia), deliberately produce for this market because they can obtain a profit from it. The most efficient producers' costs are between 10 and 12 US cents per pound of raw sugar, which at current dollar prices is between 185 and 215 ECU per tonne of white sugar. At the moment the Community intervention price is 530 ECU per tonne. *Table 9* shows the movement in the world price against the EEC intervention price. On average, over the last ten years, the European price has been almost double the world price. This comparison is an important one because export refunds are calculated on the basis of the difference between these two prices.

### The Community's place in the world market

3.4. The two more or less equal halves into which the world sugar market breaks down, namely, raw sugar and white sugar, are relatively independent of each other. Nevertheless, there is a link insofar as if there is a substantial increase in the price of white sugar, for example, it becomes worthwhile to process more raw sugar into white. Conversely, it may be preferable not to process the raw sugar into white. The Community, for its part, is concerned primarily with the white sugar market. The Community of Six was already a net exporter of white sugar. It went into a slight deficit, very briefly, at the time of the United Kingdom's accession and since then has expanded to become the world's leading exporter of white sugar, holding more than half the world market and thus accounting for some 25 % of the total free market. ***Table 10*** shows the composition of this market on both the import and the export side.

3.5. By virtue of their volume (an average of 4,8 million tonnes per year), the Community's white sugar exports necessarily affect the balance of world supply and demand on the free market. It is of course very difficult to estimate the level at which the price would be situated if the Community surpluses had no effect on the market. It is not even possible to determine the extent to which this source

**Table 9 — Comparative figures**
for the world price and the intervention price

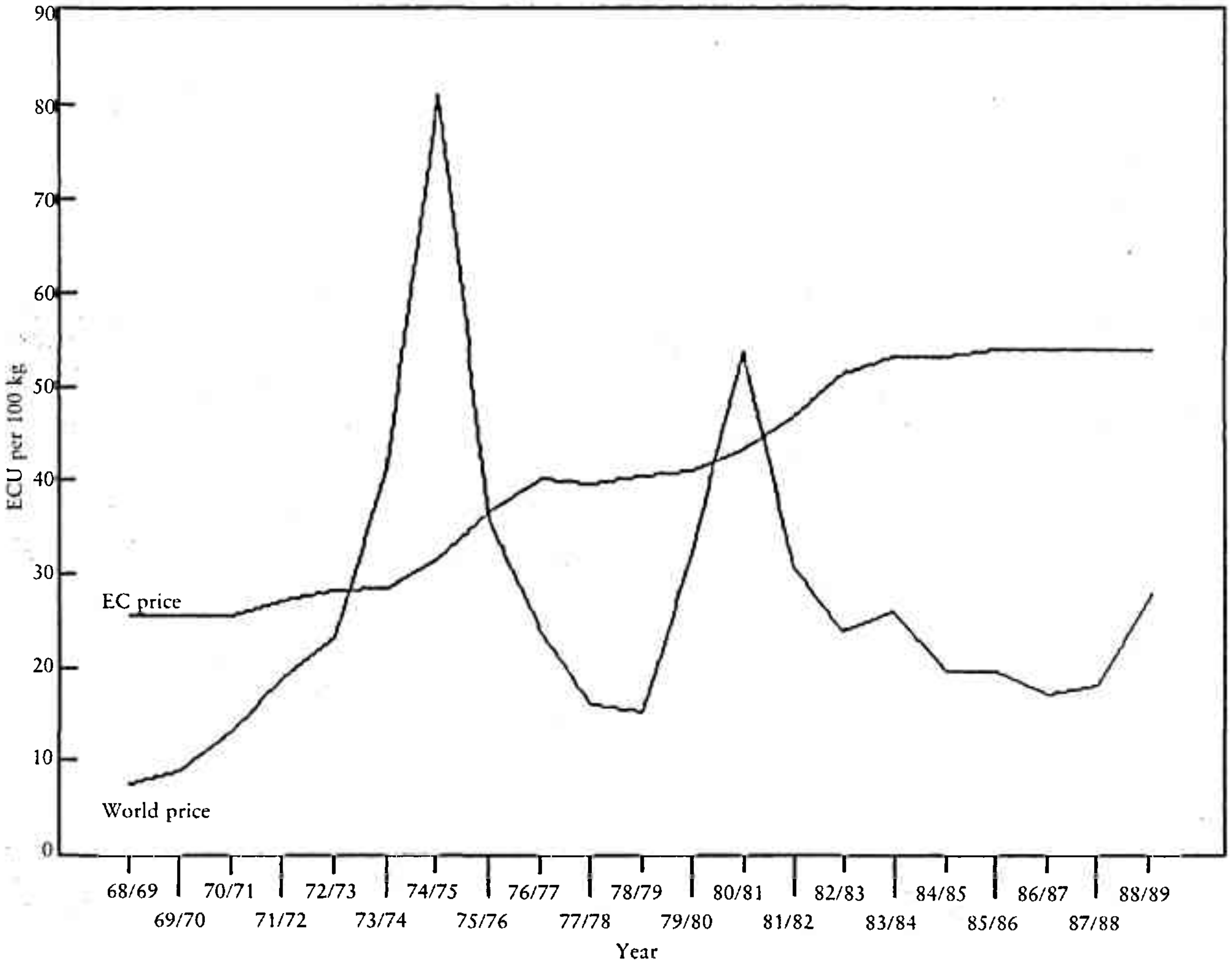

**Table 10 — Breakdown of trade on the free market in sugar**
Average quantities over the period 1985-1987

| Origin of exports | | | Destination of imports | | |
|---|---|---|---|---|---|
| | .000 t | % | | .000 t | % |
| EUROPE | 5 552 | 29,9 | EUROPE | 1 792 | 10,2 |
| of which EEC | 4 535 | 24,4 | of which USSR | 985 | 5,6 |
| CENTRAL AMERICA | 2 973 | 16,0 | CENTRAL AMERICA | 110 | 0,6 |
| of which Cuba | 1 383 | 7,5 | | | |
| Dom. Rep. | 597 | 3,3 | NORTH AMERICA | 2 334 | 13,3 |
| | | | of which Canada | 1 025 | 5,8 |
| | | | United States | 1 309 | 7,5 |
| SOUTH AMERICA | 2 947 | 15,9 | SOUTH AMERICA | 339 | 1,9 |
| of which Brazil | 2 529 | 13,6 | | | |
| ASIA | 2 405 | 13,0 | ASIA | 9 436 | 53,8 |
| of which Thailand | 1 967 | 10,6 | of which India | 1 231 | 7,0 |
| | | | Iran | 620 | 3,5 |
| | | | Iraq | 601 | 3,4 |
| | | | Japan | 1 858 | 10,6 |
| | | | Korea | 656 | 3,7 |
| AFRICA | 1 755 | 9,4 | AFRICA | 3 355 | 19,1 |
| of which South Africa | 992 | 5,3 | of which Algeria | 557 | 3,1 |
| Swaziland | 305 | 1,6 | Egypt | 708 | 4,0 |
| | | | Nigeria | 574 | 3,3 |
| OCEANIA | 2 942 | 15,8 | OCEANIA | 193 | 1,1 |
| of which Australia | 2 729 | 14,7 | | | |
| Total | 18 574 | 100,0 | | 17 559 (1) | 100,0 |

(1) The difference between total imports and total exports derives from the incompleteness of the statistical data supplied for certain net trade situations.

of supply would be replaced by increased production in other countries if it were to diminish to any great extent. It is only possible to make theoretical calculations dealing with hypothetical trends. In the studies that have been carried out on this subject (1), there are some analyses, which are already out of date (they refer to the situation before 1982), but they lead to the conclusion that the world price would be approximately 12 % higher if Community exports were to be unsubsidized.

3.6. As regards the economic effects of Community sugar exports on third countries, a distinction must be made between sugar importer and sugar exporter countries. In the case of the importer countries there is an advantage inasmuch as they are able to buy their sugar at a lower price due to the presence of 4,8 million tonnes of European sugar. These include the countries which import their sugar on non-preferential terms, i.e. from the free world market, namely African and Asian countries. On the other hand, for the exporter countries, insofar as they sell on non-preferential terms, there is a loss of revenue. To these must be added the importer countries with a level of self-sufficiency just below 100 %, which could step up production and become exporters if the price were higher.

(1) — U. Koester and P.M. Schmitz, 'The EC sugar market policy and developing countries', European Review of Agricultural Economics, Vol 9 (1982) , p. 190.
— I.M. Roberts, 'EC sugar support policies and world market prices, a comparative static analysis', Melbourne, 1982, p. 217.
— J. Zietz and A. Valdez, 'The potential benefits to LDCs of trade liberalization in beef and sugar by Industrialized Countries', Weltwirtschaftliches Archiv, Vol 122 (4), 1986.

## *Food aid*

3.7. Intervention on the Community market in order to absorb surpluses is not the aim of food aid. In any event, in the case of sugar, the amounts are very small: of the order of 6 000 tonnes per year on average.

## *The economic impact of C sugar*

### The relative importance of C sugar production

3.8. The basic idea of the system of production quotas in the sugar market is to allow any amount of sugar produced within the limits of quotas A and B to receive the guaranteed intervention price and to put any amount produced in excess of a maximum quota up for sale on world market conditions. A manufacturer may, however, decide to carry an amount of C (or B) sugar equivalent to a current maximum of 20 % of his A quota over to the following year as future A sugar by storing that amount for one year. In this way he does, of course, reduce his authorized capacity for A sugar production in the new year by an equivalent quantity, and that amount is, in fact, shifted to B or C. Apart from this reserve quantity, any manufacturer left with C sugar is obliged to export it at his own expense at the external market price before 31 December of the year in which the production season ends.

3.9. Over the last ten years, the world price for white sugar has corresponded, on average, to 53 % of the Community intervention price. If this difference were, in fact, prohibitive in economic terms, C sugar production would be the natural consequence of harvests which exceeded the seed-time forecasts as a result of exceptionally favourable climatic conditions. As *Table 11* shows, however, over the last ten years there has been an average of 1 348 000 tonnes of C sugar produced each year — the equivalent of 14,1 % of the basic quota (quota A). If this is compared with the current supply level of 142 % (see *Table 3*), i.e. a surplus of 42 %, this means that Community exports of white sugar — the commodity for which the Community is the premier international exporter — break down into one third C sugar and two thirds quota sugar.

3.10. It must be concluded, therefore, that the phenomenon of C sugar production is both too significant and too constant for it to be attributable to mere random meteorological events. It is in fact possible to demonstrate statistically on the basis of the trend of yields and the areas actually sown that it is inevitable that the maximum quota will be exceeded.

### Economic conditions for non-quota production

3.11. One reason that is frequently put forward as an explanation for systematic production in excess of the maximum quota is producers' fears of losing their shares of quota when the next reallocation takes place, on the assumption that the next quota will be based on the amount produced in a previous reference period. According to this theory, manufacturers would conclude contracts for a manufacturing volume and the growers would provide the sowings to ensure that they would at least meet their respective individual quotas under any circumstances and climatic conditions would merely determine the extent to which the quota was exceeded. This line of reasoning is incomplete, however, as will now be demonstrated.

3.12. In the case of France, a country which alone produces almost half the Community's C sugar, there is a statistical correlation between, on the one hand, the sowing of an area which corresponds statistically to C production and the movement in the world price, and, therefore, the expected sales revenue, on the other. In the case of the other countries, however, there is a statistical relationship only between the movement of the world price and decisions to carry C sugar forward to the following season (see paragraph 3.14).

3.13. On the theoretical level, the decision as to whether or not to produce C sugar tends, generally, to be influenced by an assessment of the risk of producing at a loss. This decision concerns the planters of sugar beet rather less than the sugar manufacturers, who are able to use the instrument of mixed prices (see also paragraphs 2.40 — 2.44) to obtain additional raw materials at an undifferentiated price. This makes the production of additional C beet advantageous for the growers and neutral for the manufacturers. For the latter, production of C sugar can be analysed in terms of variable costs on the basis of the principle that their fixed costs can be recovered in full on the strength of A and B sugar. Faced with the question of whether or not it is advisable to plan for production in excess of the maximum quota, there are two possibilities that can be envisaged: the marginal cost of producing C sugar is higher than the world price, or it is lower. Whereas there is a clear advantage in producing more in the latter case, in the former, where there is a risk of producing C sugar at a loss, it may nevertheless be reasonable to plan for production in excess of the maximum quota. In economic terms the explanation is as follows: to the extent that the

Table 11 — Production of C sugar, in absolute quantities and as a function of the basic quota

| Year | 78/79 | 79/80 | 80/81 | 81/82 | 82/83 | 83/84 | 84/85 | 85/86 | 86/87 | 87/88 | Average over ten years |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Prod. C in 000 t | 804 | 1 446 | 1 191 | 2 531 | 2 425 | 951 | 779 | 1 222 | 1 312 | 819 | 1 348 |
| % basic quota | 9 | 16 | 13 | 27 | 25 | 10 | 8 | 13 | 12 | 8 | 14,1 |

difference between the B sugar price and the marginal cost of producing B sugar is greater than the difference between the price of C sugar (= world price) and the marginal cost of producing C sugar, the risk of losing revenue as a result of a deficit of B sugar is greater than the risk of making a loss on the sugar produced in excess of the maximum quota (A + B).

### The influence of the carry-over mechanism

3.14. On average, over the period 1978-1988 approximately 30 % of the C sugar produced was stored and 70 % was exported. Nevertheless, these percentages may vary from one season to another according to the economic optimization decisions taken. Sugar producers are required to decide finally by 1 February of the current year the extent to which they want to use the possibility of carrying C sugar over to the following year. If they decide not to put sugar into storage, they are required to export it by 31 December of that year. It is logical, therefore, for them to take their decision in terms of the level of the world price over the same period. Statistical analysis confirms this line of reasoning: there is a very significant negative correlation between the level of the world price and the portion of C production carried forward.

3.15. The practice of carrying C sugar forward to the following season is encouraged by the fact that, within the limit of 20 % of the A quota, these amounts receive a storage premium. Although this option was understandable at a time when the level of supply was around 100 %, in that it ensured that reserve stocks were available, this is no longer the case when the level of supply is close to 150 %. Under present conditions this refund should therefore be questioned, as it is tantamount to a premium for speculating on a rise in the world price. The cost of such finance is ultimately passed on to the European consumer via the system of compensation for storage costs, which in turn is reflected in the price. Furthermore, there are grounds, under present market conditions, for questioning the economic justification of the system of carrying over C sugar, in that it encourages speculative C sugar production (see paragraph 3.12).

### The effect of C sugar exports on the cost of quota sugar exports

3.16. Community exports of white sugar amount on average to 4,8 Mio t and thus represent one quarter of the volume of trade on the free world market: this means that Community exports play a very significant role in the world balance of supply and demand. The portion represented by C sugar (approximately one third of European exports) is sufficiently large in itself for it to affect this balance. This means that exports of C sugar affect the world price and, through the pressure they exert on it, logically tend to increase the cost of export refunds for quota sugar.

3.17. It is possible to attempt to make a quantitative estimate of the extent to which the cost of quota sugar exports is increased as a result of exports of C sugar. Taking the economic projections most frequently used as a basis in this area [1], it is possible to show that a 1 Mio t reduction in C sugar (the portion of C production which can be regarded as an avoidable minimum) produces an increase of between 1,5 % and 3,1 % in the world price [2]. By applying this increase to an amount of 3,5 Mio t for quota sugar exports and taking as base a long-term balanced world price of 250 ECU/t, the cost of the export refunds would be reduced by between 15 and 30 Mio ECU per year [2]. At a rough estimate, this reduction would break down into 5 to 10 Mio ECU on the net budgetary cost and 10 to 20 Mio ECU as the cost of the co-responsibility levy.

### The effect of the predominance of C exports in a favourable world price situation

3.18. The commercial advantage of quota sugar exports is different from that of C sugar exports. In the case of the former, the aim is to maximize the rate of refund. In the case of C sugar, the objective is quite simply to take advantage of the most favourable world price possible, hence the tendency for traders to give priority to exports of C sugar at times of rising world prices.

3.19. The substitution effect between quota exports and C sugar exports is confirmed by statistical analysis of the monthly data for both categories of transaction for the period between October 1982 and May 1989. It reveals that

(1) Sources as regards elasticity:
- G. Gemmill, 'The world sugar economy: an econometric analysis of production and policies'. Michigan 1976.
- J. Roberts, O. Tie and S. Murphy, 'EEC sugar policies and world market prices', Quarterly Review of Rural Economy, Vol. 3, No 4, 1981, pp. 309-319.
- L. Schmitz and L. Goreux, 'The sugar policies of the European Community and the United States and their impact on the world sugar market', International Monetary Fund, DM/85/26, April 1985.
- U. Koester and P.M. Schmitz, 'The EC sugar policy and developing countries', European Review of Agricultural Economics, Vol. 9 (1982), pp. 183-204.

(2) Calculations by the Institute of Agricultural Economics at the University of Kiel (Germany).

there is a direct relationship between the world price and exports of C sugar and an inverse relationship between the world price and exports of quota sugar. Referring to the world price when a quota sugar refund was awarded and the world price at the time of the application for the C sugar certificate, it appears that, on average, on the basis of the series of transactions specified above, the world price for exports of quota sugar was 20 ECU/t lower than the world price for C sugar exports, at 218,6 ECU/t and 238,4 ECU/t respectively. The global average price actually obtained during this period was around 226,4 ECU/t. Had exports of quota sugar been effected at the average price in the same way as exports of C sugar, the Community would have saved around 7 ECU on each tonne of quota sugar exported, some 20 Mio ECU a year. This loss could have been avoided, partly, at least, if the Commission had adopted a more flexible and more finely-tuned strategy, so as to prevent speculative action by C sugar exporters.

3.20. The above arguments indicate that it is illusory to claim that C sugar costs the Community nothing. The two phenomena analysed in the preceding paragraphs in fact show that there is a financial charge which is a direct result of exporting C sugar, and that it can be estimated to be of the order of 30 to 60 Mio ECU per year. Of this, 10 to 20 Mio ECU are a direct charge on the budget and 20 to 40 Mio ECU are covered by production levies.

## *The effect of the ACP and Indian sugar protocol*

3.21. The importation of raw cane sugar from a number of ACP countries and India is in fact a throw-back to the arrangements for supplying the British market which existed prior to 1973. In 1986 a further 75 000 tonnes were added for Portugal. In today's common market situation these are quantities which have to be added to a European production surplus which is already considerable. At the moment two types of argument are used to justify this situation:

a) as regards protecting investment and employment in the British and Portuguese refining industries, the arguments were entirely understandable in a short, or even medium-term, perspective. The act of halting production overnight where such substantial investment is involved would amount to an act of destruction of capital, with very serious consequences. But, on the other hand, the fact that, after almost two decades, the choice between imports and domestic production for the purpose of supplying the Community market has still not been made is equally difficult to justify in a situation of over-production;

b) as regards the justification that the present system offers a guarantee for the developing countries, comprising the award of a quota to each of the countries concerned and a price which is aligned with the European intervention price. In view of the standard relationship between the world free price and the European guaranteed price, the advantages are considerable. In economic terms, however, the fact that they are able to count on a preferential price at the level at which the European quota is set does have some perverse effects on the sugar economies of the producer countries, which are still dependent on the world market price. Some ACP countries, in fact, export their quotas to the Community and import sugar from the world market to cover their own requirements.

3.22. In fact, the price advantage offered by this preferential trade constitutes a transfer of income related to a particular product. This became apparent in 1989-1990 when the Community intervention price fell by 2 %. The ACP countries complained and the Commission decided to offer them financial compensation for the resultant loss of revenue. The Community authorities should learn from this state of affairs, by reviewing the procedures for what is now, clearly, becoming a kind of income support for third-world sugar producers and thus has no place in the common agricultural policy and the budgetary expenditure it represents. Although the Court does not dispute the objective, it is of the opinion that this aspect of Community policy falls within the Community expenditure on development aid, not the EAGGF section of the general budget. Furthermore, it is significant that the Decision of 24 June 1988 on budgetary discipline [1] specifically excludes amounts for the disposal of ACP sugar.

## *The international negotiations*

### The international sugar agreements

3.23. For a very long time, the sugar-consuming and producing countries have looked for ways to control the market for this vital commodity, or at least reduce its instability. In January 1968 an international sugar agreement was signed by a number of countries providing for a stabilizing mechanism based on the creation of national stocks, commitments to buying minimum quantities and preferential supplies for the signatory States. Neither the EEC nor the United States was party to this agreement. Their absence as signatories, combined with the narrowness of the free market, resulted in the collapse of the agreement, which was not equal to the crisis of 1973-1974.

3.24. A new agreement was signed in 1978 by 31 exporter and 15 importer countries. It provided for export quotas to

(1) Council Decision of 24 June 1988 concerning budgetary discipline, OJ No L 185, 15. 7. 1988, p. 29.

be allocated to the various exporter countries, a price stabilization mechanism (within a range of 11-21 US cents per pound) and buffer stocks, which were to be built up and liquidated according to price movements. The EEC decided that it would not be a party to the agreement because, amongst other things, although the export quota proposed for it (2,9 Mio t) was sufficient to cover quota sugar exports, it was not large enough to cover the C sugar exports as well. In the end, the agreement failed. This should not, however, be allowed to prejudice any position which the Community authorities might adopt in the future and which ought to take account of the observations made by the Court in this chapter and in the preceding one.

**GATT**

3.25. In view of the importance of European sugar exports on the world market, it is not surprising if other producer and exporter countries are now trying to counter this trend, as they have done in the past. In the context of the Uruguay round of the General Agreement on Tariffs and Trade (GATT), the question of agricultural subsidies and their effects on international markets was raised again. An agricultural product like sugar is mentioned specifically on the list of products for which an agreement is to be negotiated. The position of other countries, both exporters and importers (for example the Cairns group), is such that it may lead to restrictions. It is now evident that sugar will inevitably form part of the package of agricultural products for which a reduction in the level of subsidy may be envisaged.

## 4. THE CONSEQUENCES FOR THE PUBLIC FINANCES OF THE COMMUNITY

### *Development of the budgetary situation*

4.1. The sugar and isoglucose market is the only one which entails the explicit entering of revenue, as well as expenditure, in the budget of the Communities, under the corresponding budgetary headings. ***Table 12*** shows the changing situation of revenue and expenditure, and of the net expenditure charged to the budget, resulting from these entries over the period since 1981. The table shows that average annual expenditure for the period 1981-1989 was 1 620 Mio ECU and average revenue was 1 080 Mio ECU, leaving an average charge to the budget of 540 Mio ECU. It will then be observed that, over this same period, the level of both expenditure and revenue almost doubled, but that the situation was relatively stable during the last three years, with expenditure at a level of around 2 000 Mio ECU and revenue at around 1 400 Mio ECU. The greater part of the expenditure, around 70 %, involved export refunds. The average amounts of expenditure and revenue involved in storage costs are reasonably balanced (even in budgetary ECUs), as befits a system based on the principle of equalization. In the later years, storage costs amounted to around 450 Mio ECU, or 22 % of expenditure. ***Table 13*** shows, for the average of the last three financial years, the distribution by Member State of expenditure and revenue and of the consequent net expenditure. This table demonstrates that, in accounting terms, around 75 % of the expenditure occurs in three Member States, which, in descending order of importance, are France (28 %), the Netherlands (27 %) and the Federal Republic of Germany (21 %), and which between them also account for around 65 % of the revenue recovered. It should be noted that these data are influenced by the free circulation of products when sugar is exported from a country other than the country of production, which is where the production levy was charged.

### *The costs of the surplus*

**Cost-sharing**

4.2. The financing of the common organization of the sugar and isoglucose market is unique, inasmuch as the costs occasioned by the disposal of surplus Community production are fully covered by levies paid by the producers (1) but are, at the same time, reflected in the prices and thus indirectly charged to the consumer. More precisely, the cost of exporting the difference between Community production and Community consumption and the cost of using up in the chemical industry any quantities in excess of the 60 000 tonnes traditionally used in that industry are financed by the levies system. The same principle applies to storage costs, which are covered by a specific contribution provided to that end and calculated so as to balance out the expenditure and revenue in question (expressed in green ECU) in the medium term. Other expenditure items are usually charged to the budget. This is the case for the cost of exporting a quantity equivalent to the quantity of preferential imports, the use of the first 60 000 tonnes in the chemical industry and some items of aid (for refining in particular). In order to arrive at the net cost to the budget, the revenue from import levies, particularly on molasses, must also be deducted, and the net effect of the double rate applied in the agricultural area (the production contributions are calculated in green ECU, which are different from budgetary ECU) must be added. Finally, since the market is managed by marketing year, all these items of revenue and expenditure should be set out by each sugar marketing year. The results are presented in ***Table 14***.

(1) The so-called self-financing mechanism and the related problems of accounting verification are dealt with in paragraphs 4.6-4.14 of this report.

Table 12 — Expenditure and revenue in the CMO in sugar and isoglucose over the period 1981-1989

*(in Mio ECU)*

| | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1981-1989 Average |
|---|---|---|---|---|---|---|---|---|---|---|
| *Expenditure:* | | | | | | | | | | |
| Export refunds | 409,2 | 742,5 | 758,1 | 1 190,0 | 1 352,8 | 1 238,4 | 1 515,8 | 1 566,2 | 1 451,3 | 1 136,0 |
| Refunds chemical industry | 2,4 | 2,3 | 2,3 | 3,0 | 3,5 | 5,1 | 33,4 | 63,0 | 69,3 | 20,5 |
| Other expenditure | 11,7 | 7,2 | 5,2 | 9,0 | 9,4 | 11,9 | 20,0 | 23,1 | 36,3 | 14,8 |
| Reimbursement of of storage costs | 344,3 | 489,9 | 550,5 | 429,5 | 438,9 | 470,2 | 466,4 | 429,8 | 423,0 | 449,2 |
| Total expenditure | 767,6 | 1 241,9 | 1 316,1 | 1 631,5 | 1 804,6 | 1 725,6 | 2 035,6 | 2 082,1 | 1 979,9 | 1 620,5 |
| *Revenue:* | | | | | | | | | | |
| Production levies | 125,9 | 276,9 | 468,4 | 708,1 | 548,4 | 543,9 | 603,3 | 641,1 | 647,6 | |
| Elimination levies | | | | | | 68,3 | 87,0 | 86,7 | 89,3 | 602,5 |
| Special elimination levies | | | | | | | 234,2 | 118,2 | 175,5 | |
| Other revenue | | | 1,0 | 0,2 | 0,1 | 0,1 | 0,1 | 0,0 | | 0,2 |
| Storage levies | 356,7 | 428,9 | 478,6 | 468,0 | 508,9 | 499,2 | 547,1 | 545,7 | 469,2 | 478,0 |
| Total revenue | 482,6 | 705,8 | 948,0 | 1 176,3 | 1 057,4 | 1 111,5 | 1 471,7 | 1 391,7 | 1 381,6 | 1 080,7 |
| Net charge | 285,0 | 536,1 | 368,1 | 455,2 | 747,2 | 614,1 | 563,9 | 690,4 | 598,3 | 539,8 |

**Table 13 — Breakdown of expenditure and revenue by Member State (average 1987-1989)**

*(Mio ECU)*

| | | B | DK | D | GR | E | F | IRL | I | NL | P | UK | EEC |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Expenditure:* | | | | | | | | | | | | | |
| Export | | 68,4 | 61,5 | 312,6 | 0,2 | 77,1 | 392,8 | 6,6 | 31,2 | 510,0 | 0 | 50,7 | 1 511,1 |
| refunds | % | 4,5 | 4,1 | 20,7 | 0,0 | 5,1 | 26,0 | 0,4 | 2,1 | 33,8 | 0 | 3,3 | 100 |
| Refunds chemical | | 1,1 | 1,1 | 7,9 | 0,2 | 7,8 | 18,3 | 0,4 | 2,6 | 7,0 | 0,3 | 8,5 | 55,2 |
| industry | % | 2,0 | 2,0 | 14,3 | 0,4 | 14,1 | 33,1 | 0,8 | 4,7 | 12,7 | 0,5 | 15,4 | 100 |
| Other expenditure | | 0 | 0 | 0 | 0 | 0 | 18,5 | 0 | 0 | 0 | 4,6 | 3,3 | 26,4 |
| | % | 0 | 0 | 0 | 0 | 0 | 70,1 | 0 | 0 | 0 | 17,4 | 12,5 | 100 |
| Reimbursement of | | 26,2 | 13,5 | 101,4 | 4,1 | 23,1 | 135,8 | 6,3 | 57,5 | 39,3 | 1,1 | 31,5 | 439,8 |
| storage costs | % | 6,0 | 3,1 | 23,1 | 0,9 | 5,3 | 30,9 | 1,4 | 13,1 | 8,9 | 0,2 | 7,1 | 100 |
| Total expenditure | | 95,7 | 76,1 | 421,9 | 4,5 | 108,0 | 565,4 | 13,3 | 91,3 | 556,3 | 6,0 | 94,0 | 2 032,5 |
| | % | 4,7 | 3,7 | 20,8 | 0,2 | 5,3 | 27,8 | 0,7 | 4,5 | 27,4 | 0,3 | 4,6 | 100 |
| *Revenue:* | | | | | | | | | | | | | |
| Production levies, elimination levies and special elimination | | 63,3 | 34,0 | 251,7 | 3,3 | 24,2 | 292,8 | 7,2 | 95,8 | 75,8 | 0,0 | 46,2 | 894,3 |
| levies | % | 7,1 | 3,8 | 28,1 | 0,4 | 2,7 | 32,7 | 0,8 | 10,7 | 8,5 | 0 | 5,2 | 100 |
| Other revenue | | | | | | | | | | | | | |
| | % | | | | | | | | | | | | |
| Storage levies | | 35,8 | 17,3 | 113,7 | 7,1 | 47,7 | 146,1 | 8,0 | 63,3 | 39,6 | 0,1 | 41,9 | 520,6 |
| | % | 6,9 | 3,3 | 21,8 | 1,4 | 9,2 | 28,1 | 1,5 | 12,2 | 7,6 | 0,0 | 8,0 | 100 |
| Total revenue | | 99,1 | 51,3 | 365,4 | 10,4 | 71,9 | 438,9 | 15,2 | 159,1 | 115,4 | 0,1 | 88,1 | 1 414,9 |
| | % | 7,0 | 3,6 | 25,8 | 0,7 | 5,1 | 31,0 | 1,1 | 11,3 | 8,2 | 0,0 | 6,2 | 100 |
| Net charge | | −3,4 | 24,8 | 56,5 | −5,9 | 36,1 | 126,5 | −1,9 | −67,8 | 440,9 | 5,9 | 5,9 | 617,6 |
| | % | −0,6 | 4,0 | 9,2 | −1,0 | 5,9 | 20,5 | −0,3 | −11,0 | 71,4 | 0,9 | 1,0 | 100 |

Table 14 — Distribution of charges in the CMO in sugar (in 000s of ECU)

| | | 83/84 | 84/85 | 85/86 | 86/87 | 87/88 | 88/89 | Average |
|---|---|---|---|---|---|---|---|---|
| 1. Levies | a) export refunds | 589 498 | 664 790 | 780 709 | 821 601 | 678 574 | 732 760 | 711 322 |
| | b) production refunds | 2 259 | 3 279 | 3 366 | 5 206 | 25 198 | 22 408 | 10 286 |
| | c) storage reimbursements | 465 606 | 407 846 | 435 686 | 486 329 | 414 902 | 385 916 | 432 714 |
| | d) sub-total | 1 057 363 | 1 075 915 | 1 219 761 | 1 313 136 | 1 118 674 | 1 141 084 | 1 154 322 |
| | e) 10 % levy refunds | (105 736) | (107 592) | (121 976) | (131 314) | (111 867) | (114 108) | (115 432) |
| | f) total | 951 626 | 968 324 | 1 097 785 | 1 181 822 | 1 006 806 | 1 026 976 | 1 038 890 |
| | g) % | 55 | 51 | 59 | 55 | 45 | 51 | 52 |
| 2. Budget | a) export refunds | 684 629 | 785 887 | 614 994 | 748 113 | 995 759 | 736 075 | 760 910 |
| | b) production refunds | | | | 16 622 | 23 854 | 19 627 | 10 017 |
| | c) other expenditure | 7 779 | 7 360 | 8 087 | 17 514 | 21 510 | 33 989 | 16 040 |
| | d) revenue | (900) | (900) | (900) | (2 925) | (17 732) | (14 699) | (5 708) |
| | e) effect of double rate | (23 757) | 13 089 | 30 122 | 54 702 | 119 743 | 114 745 | 51 441 |
| | f) remainder to be financed (= 1.e) | 105 736 | 107 592 | 121 976 | 131 314 | 111 867 | 114 108 | 115 432 |
| | g) total | 773 487 | 913 027 | 774 279 | 965 340 | 1 255 002 | 1 003 846 | 948 131 |
| | h) % | 45 | 49 | 41 | 45 | 55 | 49 | 48 |
| 3. Grand total for expenditure (.000 ECU) | | 1 725 113 | 1 881 351 | 1 872 063 | 2 147 162 | 2 261 808 | 2 030 822 | 1 987 021 |
| 4. Internal consumption (.000 t) | | 10 665 | 10 747 | 10 647 | 10 907 | 10 834 | 10 700 | 10 750 |
| 5. 1.f: 4 | levy, ECU per t. consumption | 89 | 90 | 103 | 108 | 93 | 96 | 97 |
| 6. 2.g: 4 | budgetary charge, ECU per t. consumption | 73 | 85 | 73 | 89 | 116 | 94 | 88 |
| 7. 3: 4 | total expenditure, ECU per t. consumption | 162 | 175 | 176 | 197 | 209 | 190 | 185 |
| 8. Intervention price | | 534,7 | 534,7 | 534,7 | 534,7 | 534,7 | 534,7 | 534,7 |
| 9. 4 × 8 | value of internal consumption | 5 702 576 | 5 746 421 | 5 692 951 | 5 831 973 | 5 792 940 | 5 721 290 | 5 748 025 |
| 10. 1.f: 9 | share of levy in the price | 16,7 | 16,9 | 19,3 | 20,3 | 17,4 | 18,0 | 18,1 |
| 11. 2.g: 9 | share of budgetary charge in the price | 13,6 | 15,9 | 13,6 | 16,6 | 21,7 | 17,5 | 16,5 |
| 12. 3: 9 | share of total financing in the price | 30,3 | 32,7 | 32,9 | 36,8 | 39,0 | 35,5 | 34,6 |

4.3. *Table 14* shows that, on average, for the period 1982/1983 — 1988/1989, the sum financed from the producers' levies ('self-financing') was 1039 Mio ECU per annum, or 52 % of the total charged to the budget. This figure allows for the reimbursement to the Member States of 10 % of the sums collected in order to cover their collection costs. Over the same period, the net amount chargeable to the Community budget was 824 Mio ECU per annum, or 42 % of the total. These percentages have been established by including in the sums those corresponding to the storage system; but this is a separate system, with a 100 % self-financing rate. It can therefore be ignored and attention concentrated solely on the cost of financing the disposal of surplus production ('self-financing'): in this respect, the charge to be financed by production levies averaged 649 Mio ECU, naturally including ACP sugar, or 42 %, while 58 % was charged against the budget. The problem of self-financing is dealt with in paragraphs 4.6-4.14 of this report.

### The relative importance of the costs

4.4. If the charges broken down in *Table 14* are compared with Community consumption, evaluated at the intervention price, which corresponds to the ex works price, it may be concluded that the cost finally passed on to the consumer corresponds to 0,097 ECU per kg of sugar, or 18 % of the consumer price. Furthermore, as a taxpayer, he also pays 0,088 ECU per kg, or 17 % of the price. The total subsidy is 0,185 ECU per kg of sugar bought by consumers in Europe, or 35 % of the consumer price. The lower part of *Table 14* gives the details by marketing year, as an average in ECU per tonne (lines 5 to 7) and as a percentage (lines 10 to 12).

### The induced costs

4.5. The principal budgetary data which we have just examined reflect the extent of the costs that are induced directly or indirectly by the characteristics of the internal or external macroeconomic management of the scheme. With regard to the principles of economy and sound financial management, the Court wishes to stress the following points:

a) the structural surplus, which must be disposed of on the world market at heavily subsidized prices, is very costly: it represents average gross expenditure of 1 987 Mio ECU per annum (see *Table 14*), which corresponds to 35 % of the value of domestic consumption;

b) the existence of so considerable a financial burden is partly concealed by the artifice of the co-responsibility mechanism, also known as self-financing, which involves covering the cost of disposing of the production surplus by levies on producers; these levies, however, are simultaneously passed on in the institutional price, which in turn determines the price charged to the consumer. The consumer, who has no alternative source of supply for this basic foodstuff, is thus obliged to contribute to financing this system; the question might therefore be asked whether the prices really are reasonable for the consumers, in the sense intended by Article 39 of the EEC Treaty;

c) another part of the financial burden has nothing to do with Community production and is generated essentially by the fact that the Community authorities have not decided between guaranteed own production, which is already in surplus, and preferential imports. The result is that both enjoy the Community guarantee. The preferential imports alone from the ACP countries and India represent an average charge to the Community budget of 535 Mio ECU a year (calculated by the Court in agricultural ECU). The Court considers that this sum is being wrongly charged to appropriations that have been earmarked for the common agricultural policy, whereas it really comes under development aid;

d) in addition to all this, there is the matter of non-quota production (C sugar), which is officially excluded from the Community guarantee but which nevertheless has financial consequences. The two phenomena analysed in paragraphs 3.16-3.20 of this report, namely the effect of exports of C sugar on the cost of exports of quota sugar and the effect of the predominance of C exports when the world price is favourable, entail a financial charge which can be evaluated at approximately 30 to 60 Mio ECU per annum. Of this charge, 10 to 20 Mio ECU comes directly from the budget and 20 to 40 Mio ECU is covered by production levies.

## *Control of self-financing*

### The mechanism

4.6. The eleventh recital of the basic regulation of 30 June 1981 (1) provides for the producers themselves to meet the costs of disposing of the surpluses arising from the excess of Community production over consumption. This concept is also known as 'self-financing', and the

(1) Council Regulation No 1785/81 of 30 June 1981 on the common organisation of the market in sugar, OJ No L 177, 1. 7. 1981, p. 4.

expression 'budgetary neutrality' is even used in connection with the common organization of the sugar market. These latter expressions can cause confusion, however: the common market organization in question is neither self-financed nor neutral in its effects on the budget. This is so because, in the first place, it is the consumers who pay the contributions, as a fraction of the price. Secondly, only part of the expenditure is covered by these contributions. The recital in the regulation cited above makes this clear: the aim is to finance the cost of disposing of the surplus of Community production over Community consumption.

4.7. Articles 28 and 28(a) of the same basic regulation provide a very precise definition of how this financial contribution is to be approached. For each marketing year, estimates are first made and then the actual figures recorded for the following:

a) the quantity of A and B sugar and of A and B isoglucose produced for the marketing year in question;

b) the quantity of sugar and isoglucose sold for consumption within the Community during the same marketing year;

c) the so-called 'exportable surplus', obtained by subtracting the quantity referred to at b) from the quantity referred to at a);

d) the average loss (or, if appropriate, the average revenue) [1] per tonne of sugar earmarked for export or for use in the chemical industry (more than 60 000 tonnes per annum where the latter is concerned) in respect of the marketing year in question;

e) the amount to be covered by the levies, multiplying the quantity discussed at c) by the amount referred to at d).

4.8. From the 1986/87 marketing year on, this calculation is made cumulatively, so as automatically to absorb any adjustments which might follow on from any subsequent corrections of the figures for the previous marketing years. Once the global amount to be covered has been determined in this way, the levies are set by a system of percentages applicable to the intervention price, which vary according to whether the sugar is A or B sugar and are stepped, in the case of the latter, in accordance with a scale supplemented by an additional levy which is applied on a linear basis to the amount of the A and B levies in order to make up for the remaining shortfall. The data in ***Table 14*** show that, if the other items of expenditure and revenue are taken into account, with the exception of the storage allowances, which are 100 % covered by the storage levies, a little less than one-half of the expenditure, 42 %, has been 'self-financed' (see paragraph 4.3). If expenditure and revenue relating to the system of equalization of storage costs are included — although they do not come under the concept of self-financing as understood in the regulation — this percentage comes to around 52 %.

## The problem of accounting control

4.9. If an objective such as 100 % financing by the producers themselves of the costs of disposing of surplus Community production has been explicitly proclaimed, it is worth checking whether it has in fact been achieved. This was one of the Court's intentions when it undertook a financial audit of the sugar and isoglucose sector at the Commission in 1989. The audit work carried out in this context revealed considerable technical difficulties standing in the way of establishing beyond any doubt the degree to which the objective of self-financing was being achieved. The ensuing discussions between the Court and Commission officials, and the arguments advanced by both sides in the part of the 1988 annual report devoted to this subject, showed that certain methodological problems needed to be clarified first.

4.10. It was for this reason that the Council, in its opinion on the discharge for the 1988 financial year, considered it 'urgent for the two institutions to reach an agreement on an identical method of analysis'. The Council also agreed with the Court 'on the need for the means to be available to evaluate, in accounting terms too, whether the principle of self-financing is being respected'. The European Parliament, in its discharge decision for the 1988 financial year, announced its intention to 'review the question of the financial neutrality of the sugar sector in the light of the communications from the Commission and the Court of Auditors'. In view of this request by the budgetary authority, it was decided to carry out an in-depth study of the problem and to include the results of this study in this report. Thus, the Court's auditors carried out a detailed analysis on the basis of the raw data made available by the departments of the Commission.

## Accounting analysis

4.11. The implementation of the principle of self-financing in the sugar sector goes back to the application of

[1] Council Regulation (EEC) No 1785/81 of 30 June 1981, Article 28, paragraph 1, under d, second indent: 'This average loss or average return shall be equal to the difference between the sum of the refunds and the sum of the levies as a proportion of the total tonnage of the export commitments concerned', OJ No L 171, 1. 7. 1981.

the approach contained in Articles 28 and 29 of the basic regulation for the determination of production levies, including the additional levy (see paragraphs 4.6-4.8). The accounting control on the implementation of this principle must therefore concern the subsequent entering in the accounts of the elements concerned in this calculation, which at that stage are statistical or estimated. Comparing the accounting data on expenditure effected and revenue received, on the one hand, with the data used in calculating the levies, on the other, presents a whole series of technical difficulties, which are listed hereafter:

a) Article 28 defines the amount to be financed as the difference between Community production of quota sugar and isoglucose, on the one hand, and the quantity of sugar and isoglucose disposed of for consumption in the Community, on the other, multiplied by the average amount of refunds granted; these are therefore global concepts and statistical averages, and do not correspond to any accounting entry;

b) still on the definitions from Article 28, the amount of the average refund, which is multiplied by the exportable surplus to arrive at the sum to be financed by the levies, is determined on the basis of export commitments (and commitments for the chemical industry in excess of 60 000 tonnes per annum). This concept of a commitment corresponds to the quantities allocated to successful tenderers and not to the quantities involved in the actual operations. In particular, it takes no account of any variations in the quantities within the margin of use (+ or — 5 %), or of non-use of certificates; questions might be asked on the compatibility of this provision with the objective, which, in the recital of the regulation, is stated in terms of 'full financing (......) of the disposal costs';

c) given that these regulations were adopted in the context of the common agricultural policy, the financial aspects are expressed in agricultural ECU; for the purposes of comparison with the budgetary accounting, which is in budgetary ECU, the figures have to be reduced to a common denominator; the exchange rate difference between the agricultural ECU and the budgetary ECU must therefore be eliminated; but, far from being marginal, this difference represents a sizeable magnitude, as will be seen below;

d) the calculations concerning self-financing and, therefore, all the data used in this calculation, refer to the marketing year for sugar and isoglucose, i.e. the period from 1 July to 30 June; the budgetary accounting covers the period of the financial year, 1 January to 31 December or, more recently, for the EAGGF Guarantee Section, 16 October to 15 October; the two sets of totals cannot therefore be compared in any way;

e) the rate at which expenditure, in particular, is entered in the accounts reveals a time lag, compared with the events that give rise to the expenditure, which varies over time and from one Member State to another; these are amounts paid to operators on presentation of a certificate of entitlement which may bear an issue date going back several months; these payments are effected and entered in the accounts by paying agencies in the Member States, who declare this expenditure to the Commission, which in turn reimburses them, whereupon these sums are entered in the Community's accounts; the time which has elapsed between the issue of the certificate and the recording of its financial consequences in the accounts is too dependent on all sorts of operational and administrative delays for there to be any stable link between an act of management in a given month and the accounting entries made during a specific later month.

4.12. In an attempt to resolve all these problems, the Court's auditors were obliged to analyse all the expenditure and revenue operations down to the smallest detail — in terms of the budgetary item, the reference marketing year, the month in which the certificate of entitlement was issued, the month of the accounting entry, the amount in national currency, agricultural ECU and budgetary ECU — in order to establish sets of data for those used in the system for calculating self-financing, on the one hand, and for those which appear in the budgetary accounting, on the other. Processing of these data provided the following results.

4.13. **The results of the analysis**

a) In the first place, it should be noted that the analysis carried out proved to be extremely laborious, not only because of the technical complications listed in the preceding paragraph but also in view of the difficulties encountered in obtaining, from the departments of the Commission, the exact data needed by this analysis and in an appropriate form. These practical difficulties clearly demonstrated that the Commission is not accustomed to carrying out this type of control. In fact, an almost total lack of internal control on this specific point was noted within the departments of the Commission. It is clear to the Court that the existence of this situation cannot be attributed solely to the sole market division concerned within the Directorate-General for Agriculture; the Court's criticism is directed at all the departments of the Commission which are concerned (the EAGGF Directorate at the Directorate-General for Agriculture, the Directorate-General for Budgets and Financial Control);

b) the differences arising from the conversion of sums denominated in budgetary ECU into agricultural ECU are shown in ***Table 15***. The net effect is substantial and it increases the share of the expenditure in respect of this market which is financed from the Community budget, since this, by definition, remains outside the self-financing mechanism;

Table 15 — Exchange rate differences ('green' rates — budgetary rates)

(in 000s of ECU)

| | 1983/1984 | 1984/1985 | 1985/1986 | 1986/1987 | 1987/1988 | 1988/1989 |
|---|---|---|---|---|---|---|
| *Expenditure* | | | | | | |
| Export refunds | (4 745) | 37 304 | 57 185 | 89 091 | 187 722 | 163 824 |
| Chemical industry refunds | 165 | 202 | 184 | 342 | 3 007 | 5 715 |
| Other expenditure | (442) | 19 | 268 | 440 | 3 090 | 2 183 |
| Reimbursement of storage costs | (2 695) | 12 054 | 18 594 | 31 668 | 38 670 | 40 702 |
| Total for expenditure | (7 717) | 49 579 | 76 231 | 121 541 | 232 489 | 212 424 |
| *Revenue* | | | | | | |
| Production levies | 8 331 | 18 541 | 24 479 | 33 569 | 47 972 | 49 212 |
| Elimination levies | 0 | 0 | 0 | 4 119 | 6 855 | 6 218 |
| Special elimination levies | 0 | 0 | 0 | 0 | 18 432 | 7 952 |
| Storage levies | 7 709 | 17 949 | 21 630 | 29 151 | 39 487 | 34 297 |
| Total for revenue | 16 040 | 36 490 | 46 109 | 66 839 | 112 476 | 97 679 |
| Net difference | (23 757) | 13 089 | 30 122 | 54 702 | 119 743 | 114 745 |

c) a regression analysis of the series of monthly sums on which self-financing calculations, on the one hand, and the corresponding monthly budgetary expenditure, converted into agricultural ECU, on the other hand, are based, demonstrated that there is no significant correlation between the two series, for any set delay factor; for each category of expenditure involved in the calculation, however, the delay which gave the best correlation was taken for the rest of the analysis;

d) since the statistical correlation is insufficient, there is only one method left for comparing the two groups of data: to add up the figures for the two series that are to be compared over a sufficiently long period for the results of the variations due to the factor cited above (see paragraph 4.11.e)) to become relatively insignificant, and then to evaluate the trend of the remaining balance. The results of these analyses are given in *Tables 16, 17 and 18*. The analyses were carried out in two series; a first series started from 1 January 1983, the date with effect from which the necessary data are available at the Commission; and from 1 July 1986, when the five-year arrangements currently in force began. While the percentages concerning the revenue and the production refunds in the chemical industry seem acceptable, a question mark hangs over the export refunds. The variation is too constant and too great for it to be explained by the user margin of 5 % maximum. This result of 7 to 8 % first raises once again the problem of reference to hypothetical or real charges mentioned in paragraph 4.11.b) above, but then proves that there is a need for verification. The most plausible explanation for the difference is non-use of certificates issued, but apparently the departments of the Commission do not have the monitoring resources to observe this phenomenon;

e) this statistical correlation analysis is the only means of assessing the extent to which the calculation data which determine self-financing, on the one hand, and the realisation of this, in the accounts, on the other, actually correspond. Varying time-lags between commitment operations, on the one hand, and accounting entries, on the other, an expenditure and revenue situation which ought to balance cannot be established with the current accounting system.

**Assessment of sound financial management in the area of self-financing**

4.14. The analysis carried out by the auditors allowed most of the obstacles cited in paragraph 4.11, above, to be overcome. Nevertheless, it is important to note that one of these obstacles is still there, since it is impossible to carry out an accurate control within the present system of accounting for revenue and expenditure. Moreover, where the statistical analysis carried out in its stead by the Court is concerned, its laborious nature and the difficulties encountered in carrying it out prove that the management and accounting organization of the departments of the Commission is not really suited to carrying out the control as intended. The principles of sound financial management nevertheless require the achievement of so fundamental an aim as self-financing in the sugar sector to be checked against independent data which reflect the real financial

**Table 16 — Expression in accounting terms of volume of export licences**

*(in Mio of 'green' ECU with five months' time-lag)*

| | Value of licences | Total licences since 8301 | Total licences since 8607 | Expenditure in 'green' ECU | Total expenditure since 8301 | Total expenditure since 8607 | Difference expenditure licences | Total difference since 8301 | Total difference since 8607 | Total difference in % licences | Total difference in % licences |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 8301 | 85 | 85 | | 71 | 71 | | −14 | −14 | | | |
| 8302 | 66 | 151 | | 81 | 152 | | 15 | 1 | | 0,66 | |
| 8303 | 86 | 237 | | 44 | 196 | | −42 | −41 | | −17,30 | |
| 8304 | 57 | 294 | | 44 | 240 | | −13 | −54 | | −18,37 | |
| 8305 | 65 | 359 | | 61 | 301 | | −4 | −58 | | −16,16 | |
| 8306 | 36 | 395 | | 53 | 354 | | 17 | −41 | | −10,38 | |
| 8307 | 40 | 435 | | 41 | 395 | | 1 | −40 | | −9,20 | |
| 8308 | 79 | 514 | | 87 | 482 | | 8 | −32 | | −6,23 | |
| 8309 | 79 | 593 | | 66 | 548 | | −13 | −45 | | −7,59 | |
| 8310 | 82 | 675 | | 74 | 622 | | −8 | −53 | | −7,85 | |
| 8311 | 95 | 770 | | 75 | 697 | | −20 | −73 | | −9,48 | |
| 8312 | 86 | 856 | | 109 | 806 | | 23 | −50 | | −5,84 | |
| 8401 | 82 | 938 | | 92 | 898 | | 10 | −40 | | −4,26 | |
| 8402 | 98 | 1036 | | 118 | 1016 | | 20 | −20 | | −1,93 | |
| 8403 | 114 | 1150 | | 101 | 1117 | | −13 | −33 | | −2,87 | |
| 8404 | 110 | 1260 | | 92 | 1209 | | −18 | −51 | | −4,05 | |
| 8405 | 134 | 1394 | | 153 | 1362 | | 19 | −32 | | −2,30 | |
| 8406 | 118 | 1512 | | 112 | 1474 | | −6 | −38 | | −2,51 | |
| 8407 | 118 | 1630 | | 93 | 1567 | | −25 | −63 | | −3,87 | |
| 8408 | 106 | 1736 | | 100 | 1667 | | −6 | −69 | | −3,97 | |
| 8409 | 93 | 1829 | | 58 | 1725 | | −35 | −104 | | −5,69 | |
| 8410 | 110 | 1939 | | 65 | 1790 | | −45 | −149 | | −7,68 | |
| 8411 | 143 | 2082 | | 106 | 1896 | | −37 | −186 | | −8,93 | |
| 8412 | 95 | 2177 | | 110 | 2006 | | 15 | −171 | | −7,85 | |
| 8501 | 141 | 2318 | | 116 | 2122 | | −25 | −196 | | −8,46 | |
| 8502 | 119 | 2437 | | 160 | 2282 | | 41 | −155 | | −6,36 | |
| 8503 | 90 | 2527 | | 103 | 2385 | | 13 | −142 | | −5,62 | |
| 8504 | 96 | 2623 | | 127 | 2512 | | 31 | −111 | | −4,23 | |
| 8505 | 133 | 2756 | | 216 | 2728 | | 83 | −28 | | −1,02 | |
| 8506 | 106 | 2862 | | 55 | 2783 | | −51 | −79 | | −2,76 | |
| 8507 | 140 | 3002 | | 89 | 2872 | | −51 | −130 | | −4,33 | |
| 8508 | 167 | 3169 | | 102 | 2974 | | −65 | −195 | | −6,15 | |
| 8509 | 124 | 3293 | | 88 | 3062 | | −36 | −231 | | −7,01 | |
| 8510 | 110 | 3403 | | 98 | 3160 | | −12 | −243 | | −7,14 | |
| 8511 | 111 | 3514 | | 84 | 3244 | | −27 | −270 | | −7,68 | |
| 8512 | 117 | 3631 | | 79 | 3323 | | −38 | −308 | | −8,48 | |
| 8601 | 139 | 3770 | | 83 | 3406 | | −56 | −364 | | −9,66 | |
| 8602 | 137 | 3907 | | 114 | 3520 | | −23 | −387 | | −9,91 | |
| 8603 | 150 | 4057 | | 151 | 3671 | | 1 | −386 | | −9,51 | |
| 8604 | 126 | 4183 | | 138 | 3809 | | 12 | −374 | | −8,94 | |
| 8605 | 118 | 4301 | | 126 | 3935 | | 8 | −366 | | −8,51 | |
| 8606 | 144 | 4445 | | 54 | 3989 | | −90 | −456 | | −10,26 | |
| 8607 | 93 | 4538 | 93 | 57 | 4046 | 115 | −36 | −492 | −36 | −10,84 | −38,71 |
| 8608 | 60 | 4598 | 153 | 101 | 4147 | 216 | 41 | −451 | 5 | −9,81 | 3,27 |
| 8609 | 80 | 4678 | 233 | 74 | 4221 | 290 | −6 | −457 | −1 | −9,77 | −0,43 |
| 8610 | 138 | 4816 | 371 | 59 | 4280 | 349 | −79 | −536 | −80 | −11,13 | −21,56 |
| 8611 | 129 | 4945 | 500 | 106 | 4386 | 455 | −23 | −559 | −103 | −11,30 | −20,60 |
| 8612 | 129 | 5074 | 629 | 143 | 4529 | 598 | 14 | −545 | −89 | −10,74 | −14,15 |
| 8701 | 116 | 5190 | 745 | 156 | 4685 | 754 | 40 | −505 | −49 | −9,73 | −6,58 |
| 8702 | 143 | 5333 | 888 | 134 | 4819 | 888 | −9 | −514 | −58 | −9,64 | −6,53 |
| 8703 | 151 | 5484 | 1039 | 246 | 5065 | 1134 | 95 | −419 | 37 | −7,64 | 3,56 |
| 8704 | 272 | 5756 | 1311 | 23 | 5088 | 1157 | −249 | −668 | −212 | −11,61 | −16,17 |
| 8705 | 336 | 6092 | 1647 | 347 | 5435 | 1504 | 11 | −657 | −201 | −10,78 | −12,20 |
| 8706 | 221 | 6313 | 1868 | 195 | 5630 | 1699 | −26 | −683 | −227 | −10,82 | −12,15 |
| 8707 | 186 | 6499 | 2054 | 127 | 5757 | 1826 | −59 | −742 | −286 | −11,42 | −13,92 |
| 8708 | 168 | 6667 | 2222 | 128 | 5885 | 1954 | −40 | −782 | −326 | −11,73 | −14,67 |
| 8709 | 163 | 6830 | 2385 | 105 | 5990 | 2059 | −58 | −840 | −384 | −12,30 | −16,10 |
| 8710 | 138 | 6968 | 2523 | 147 | 6137 | 2206 | 9 | −831 | −375 | −11,93 | −14,86 |
| 8711 | 107 | 7075 | 2630 | 148 | 6285 | 2354 | 41 | −790 | −334 | −11,17 | −12,70 |
| 8712 | 75 | 7150 | 2705 | 107 | 6392 | 2461 | 32 | −758 | −302 | −10,60 | −11,16 |
| 8801 | 75 | 7225 | 2780 | 119 | 6511 | 2580 | 44 | −714 | −258 | −9,88 | −9,28 |
| 8802 | 89 | 7314 | 2869 | 80 | 6591 | 2660 | −9 | −723 | −267 | −9,89 | −9,31 |
| 8803 | 116 | 7430 | 2985 | 85 | 6676 | 2745 | −31 | −754 | −298 | −10,15 | −9,98 |
| 8804 | 91 | 7521 | 3076 | 17 | 6693 | 2762 | −74 | −828 | −372 | −11,01 | −12,09 |
| 8805 | 183 | 7704 | 3259 | 158 | 6851 | 2920 | −25 | −853 | −397 | −11,07 | −12,18 |
| 8806 | 201 | 7905 | 3460 | 351 | 7202 | 3271 | 150 | −703 | −247 | −8,89 | −7,14 |
| 8807 | 127 | 8032 | 3587 | 169 | 7371 | 3440 | 42 | −661 | −205 | −8,23 | −5,72 |
| 8808 | 88 | 8120 | 3675 | 101 | 7472 | 3541 | 13 | −648 | −192 | −7,98 | −5,22 |
| 8809 | 157 | 8277 | 3832 | 102 | 7574 | 3643 | −55 | −703 | −247 | −8,49 | −6,45 |
| 8810 | 133 | 8410 | 3965 | 66 | 7640 | 3709 | −67 | −770 | −314 | −9,16 | −7,92 |
| 8811 | 135 | 8545 | 4100 | 85 | 7725 | 3794 | −50 | −820 | −364 | −9,60 | −8,88 |
| 8812 | 107 | 8652 | 4207 | 102 | 7827 | 3896 | −5 | −825 | −369 | −9,54 | −8,77 |
| 8901 | 74 | 8726 | 4281 | 74 | 7901 | 3970 | 0 | −825 | −369 | −9,45 | −8,62 |
| 8902 | 86 | 8812 | 4367 | 74 | 7975 | 4044 | −12 | −837 | −381 | −9,50 | −8,72 |
| 8903 | 88 | 8900 | 4455 | 93 | 8068 | 4137 | 5 | −832 | −376 | −9,35 | −8,44 |
| 8904 | 80 | 8980 | 4535 | 64 | 8132 | 4201 | −16 | −848 | −392 | −9,44 | −8,64 |
| 8905 | 125 | 9105 | 4660 | 14 | 8146 | 4215 | −111 | −959 | −503 | −10,53 | −10,79 |
| 8906 | 103 | 9208 | 4763 | 208 | 8354 | 4423 | 105 | −854 | −398 | −9,27 | −8,36 |
| 8907 | 79 | 9287 | 4842 | 138 | 8492 | 4561 | 59 | −795 | −339 | −8,56 | −7,00 |

Table 17 — Expression in accounting terms of utilization licences for the chemical industry

*(in 000s of 'green' ECU with 7 months' time-lag))*

| Quarter | Value of licences | Total licences since 8607 | Expenditure in 'green' ECU | Total expenditure since 8607 | Difference between exp. and licences | Total difference since 8607 | Total difference in % licences |
|---|---|---|---|---|---|---|---|
| 86 - III | 7 234 | 7 234 | 6 755 | 6 755 | −479 | −479 | −6,62 |
| 86 - IV | 12 582 | 19 816 | 10 312 | 17 067 | −2 270 | −2 749 | −13,87 |
| 87 - I | 8 136 | 27 952 | 8 967 | 26 034 | 831 | −1 918 | −6,86 |
| 87 - II | 10 498 | 38 450 | 14 971 | 41 005 | 4 473 | 2 555 | 6,64 |
| 87 - III | 11 606 | 50 056 | 8 258 | 49 263 | −3 348 | −793 | −1,58 |
| 87 - IV | 19 437 | 69 493 | 19 653 | 68 916 | 216 | −577 | −0,83 |
| 88 - I | 21 134 | 90 627 | 18 771 | 87 687 | −2 363 | −2 940 | −3,24 |
| 88 - II | 20 728 | 111 355 | 17 272 | 104 959 | −3 456 | −6 396 | −5,74 |
| 88 - III | 15 515 | 126 870 | 15 982 | 120 941 | 467 | −5 929 | −4,67 |
| 88 - IV | 12 659 | 139 529 | 16 546 | 137 487 | 3 887 | −2 042 | −1,46 |
| 89 - I | 18 455 | 157 984 | 14 366 | 151 853 | −4 089 | −6 131 | −3,88 |
| 89 - II | 14 049 | 172 033 | 11 671 | 163 524 | −2 378 | −8 509 | −4,95 |

Table 18 — Expression in accounting terms of levies established

*(in 000s of 'green' ECU)*

| | Levies fixed | Accumulated levies | Revenue | Accumulated revenue | Difference between revenue and levies | Accumulated difference | Accumulated difference as a % of levies |
|---|---|---|---|---|---|---|---|
| 1982/83 | 516 832 | 516 832 | 511 506 | 511 506 | (5 326) | (5 326) | (1,03) |
| 1983/84 | 453 238 | 970 070 | 446 906 | 958 412 | (6 332) | (11 658) | (1,20) |
| 1984/85 | 507 451 | 1 477 226 | 508 438 | 1 466 850 | 1 282 | (10 376) | (0,70) |
| 1985/86 | 516 774 | 1 994 000 | 514 062 | 1 980 912 | (2 712) | (13 088) | (0,66) |
| 1986/87 | 811 049 | 2 805 049 | 780 562 | 2 761 474 | (30 487) | (43 575) | (1,55) |
| 1987/88 | 680 310 | 3 485 359 | 681 832 | 3 443 306 | 1 522 | (42 053) | (1,21) |
| 1988/89 | 747 029 | 4 232 388 | 738 747 | 4 182 053 | (8 282) | (50 335) | (1,19) |

position. The result of the analysis shows that the real situation should be examined by comparison with the forecasts, because a significant discrepancy is to be found in the largest item of expenditure. Since the type of analysis carried out on that occasion is too unwieldy to be repeated regularly, the accounting organization should be adapted to the needs of a system of quasi-automatic control. Such a control could be carried out simply by providing for a declaration of expenditure and revenue by the Member States which distinguished between the marketing years for which they were effected. Such a degree of specification would not make excessive demands on the corresponding authorities in the Member States, since they already have the necessary information for their own management purposes. It would thus be possible to measure the extent to which 'self-financing' is achieved within the narrow limits recalled in paragraphs 4.6-4.8 on a regular basis, from one year to another.

## *Other specific observations on sound financial management*

### Export refunds

4.15. The payment of export refunds is conditional upon the issue of certificates which allow the correct and timely execution of the operations to be monitored, and also upon a system of sureties which penalizes cases of infringement. The implementation of these safeguard measures, like those in respect of other operations, is assigned to the corresponding authorities in the Member States. Such decentralization, however, can by no means reduce the Community's overall responsibility for the correct execution of the operations; on the contrary, it imposes an obligation to provide coordination and central control. In its annual report concerning the financial year 1988, on the basis of a survey carried out among the responsible paying agencies in several Member States, the Court concluded that the national procedures should be harmonized in order to obtain the same level of effectiveness and guaranteed regularity [1]. Likewise, at the time of the investigation on which this report is based, it was found that operations effected by way of market regulation were not being adequately monitored from the centre. More especially, the Commission has no mechanism for systematically checking on the satisfaction of export commitments established when the contracts are awarded. This absence of a suitable mechanism also constitutes an obstacle to the task of checking the correct functioning of the self-financing system in terms of its objectives.

**Production refunds**

4.16. When the production refunds system for the use of sugar in the chemical industry was instituted, the aim was to create an additional outlet for surpluses. This also had the effect, however, of creating competition for starch. This derived product (mainly obtained from cereals and potatoes) is also subject to common market regulation. It provides the basis for the production of a whole range of products, both foodstuffs and others, including isoglucose and glucose. This latter is in competition with sugar as a raw material for the production by the chemical industry of certain products, such as citric acid, which is used in the food-manufacturing industry. The regulation on production aid in the chemical industry was designed to ensure balanced conditions between the two alternative raw materials. Thus, the production refund granted for sugar was accompanied by a deduction of 70 ECU per tonne in relation to the difference between the Community price and the world price, even though the chemical industry is attempting to put itself on equal terms with its international competitors outside the Community. The wish to ensure equality between sugar and isoglucose has also affected the administrative procedures for the measure: thus, the rate of refund is established four times a year, which is not at all suited to the working rhythms of the chemical industry; furthermore, particularly cumbersome administrative and control procedures were set up. Amongst the latter, the lodging of a security for correct use which serves no real purpose deserves mention, since the payment of the aid is subject to random controls to determine that it is used correctly.

4.17. Meanwhile, with effect from 1 July 1990, the system of aid for sugar has been completely separated from the same system laid down by the common market organization rules for cereals and starch. This is one more reason for re-examining the administrative procedures applicable to sugar so that the system becomes more attractive for the chemical industry. The unwieldiness of the Community system has hitherto resulted, according to the information obtained from the representatives of this sector, in the industry's opting for molasses, in which the Community has a deficit and which therefore has to be imported, rather than sugar or isoglucose. And yet those concerned estimate that there is potentially capacity to absorb several hundred thousand tonnes of sugar. The group of measures should therefore be managed in such a way as to make full use of this internal outlet in order to absorb the surpluses rather than tackle it using imports.

## *The administrative management by the Commission and the Member States*

4.18. The sugar and isoglucose market is a highly organized sector. In the first place, the products concerned are of agricultural origin and must necessarily be obtained by industrial processing. Second, the product which is principally concerned, white sugar, is a homogeneous product for which the regulation provides only one quality. Lastly, the industrial plants, which provide the inevitable link between agricultural production and the consumer product, are not very numerous, as seen above (200 sugar refineries belonging to fewer than 100 undertakings). There are even fewer isoglucose plants than sugar mills, and ownership is especially concentrated, for the greater part within the sugar industry.

4.19. As the organization of this market is concentrated on a relatively limited number of clearly identified key points, its management and control are therefore relatively uncomplicated by comparison with other markets. A system of production quotas is easy to manage for so few direct beneficiaries. Likewise, the collection of levies, to cover part of the financing requirements, from so few economic agents is easily effected and monitored.

4.20. It is therefore not surprising that the administrative organization, at the level of both the European Commission and the national authorities, is generally well ordered. The management procedures are generally competently implemented, i.e. with good knowledge of this relatively transparent market and on the basis of relatively reliable data. The administrative control is further reinforced by very regular contacts between Community and national departments, particularly at the weekly meetings of the management committee. Any observations made in the

(1) Annual report concerning the financial year 1988, OJ No C 312, 12. 12. 1989, pp. 87-92.

preceding paragraphs on the effectiveness of the administrative organization are to be understood in this general context.

## 5. CONCLUSION

### *A seemingly coherent system*

5.1. By comparison with other agricultural markets, the sugar market is, in principle, relatively easy to manage and to monitor. Sugar consumption is homogeneous. The product does not come in different qualities, any variations being a question of different presentations. The raw material obtained from agriculture is processed industrially. For technical and economic reasons, this processing is carried on in a very limited number of plants (of the order of 200) through which the product has to pass.

5.2. This is a heavy industry, requiring substantial investment and in which policy needs to be developed according to clear long-term guidelines. But the limited number of companies concerned (less than 100 at present, and the numbers are declining) makes it easier for the operators to unite in defence of their interests, to the point where they could establish dominant market positions, thereby jeopardizing the conditions required for genuine competition.

5.3. The management mechanism implemented on this market presents manifest peculiarities by comparison with other common market organizations while nevertheless sharing certain customary features, such as the prices system and the institution of a levy or import and export refunds. The peculiarities are the following:

a) a simple general system of production quotas;

b) the costs of disposing of the excess of production over consumption are usually fully financed from production levies;

c) a system of equalizing storage costs between the producers and the main sugar stockholders.

These peculiarities can be attributed partly to historical reasons, such as the existence, when the Sugar CMO was set up in 1968, of a problem of surpluses and disparities between the constituent sugar-producing economies, and partly to the specific structure of the market, as mentioned above (paragraph 5.1). Taken together, these measures, both traditional and special, constituted one of the potentially strongest and most effective mechanisms for ensuring the regulation and control of a common market organization.

### *A system adrift*

5.4. After 22 years of common organization of the markets in the sugar sector, it must be concluded that the experiment of organizing these markets on a Community basis has failed. The way the system has developed has run counter to the very concept of the common market, as contained in Article 40 of the Treaty, and several of the essential objectives assigned to the Common Agricultural Policy by Article 39 of the EEC Treaty have not been attained. The fact is that while certain principles proclaimed by this Article (increased productivity, security of supply) were achieved long ago, the same cannot be said of others (rational development of agricultural production, stabilization of the market and reasonable prices for the consumer). Furthermore, an additional objective which came to the fore in the 1980s, namely the control of production and thus of the expenditure linked to surpluses, is especially far from being achieved in the sugar market, where oversupply is of the order of 150 % and total spending is of the order of 2 000 Mio ECU.

5.5. As things stand currently, the European market in sugar is anything but a common market: it is no more than the sum of the individual national markets. Production is tied to the territories of the Member States by production quotas which are set per Member State. More effective production cannot be developed because less efficient production is protected. The initial disparities which existed when the CMO was set up, or when new members joined, are still there. So-called transitional measures have played a large part in this process because they have been kept in place beyond their original deadline. The then Member of the Commission with responsibility for Agriculture, who was a Vice-President of the Commission, made the following comments in a speech to the Economic and Social Committee on 28 September 1967, and therefore right in the middle of the preparatory stages of the sugar CMO: 'There are grounds for fearing that at some time in the future the Council will agree upon a system whereby after a certain period it will no longer be possible to achieve a common market in sugar (...). All the measures that we must take should be such as to make it possible to open frontiers after the transitional period, resulting in specialization in the production of sugar. This question deserves particular attention, since it is the first time that we have encountered such difficulties and that national interests have been defended so rigorously.'

5.6. In fact the system of production quotas, which has been a major idiosyncrasy of this market since it was set up and is, in theory, an effective means of controlling and guiding production, is the factor in the equation that has led to the ossification and under-optimization which currently characterizes this market. Instead of allowing backward regions to adapt and making it easier for overall production to develop towards a macroeconomic optimum, with a common market as the ultimate aim, the way in which the system has actually been implemented by the political authorities has tended rather to move the sugar market in the opposite direction, away from its objectives. The quota instrument has been systematically extended with every change in the system, in order to safeguard producers who were less efficient from the start, especially in Italy, and subsequently to satisfy new Member States, whether their natural conditions were suited to growing sugar beet or not, so as to make them self-sufficient at least — with the characteristic examples of the Norwegian quota for Denmark and the new sugar beet production quota in mainland Portugal. The instrument has also been used both to offer guarantees to the former Commonwealth countries that their exports of raw sugar to the United Kingdom will be maintained and to ensure this supply of raw material for the British industry. The quota mechanism has even prevented isoglucose, which costs less to produce, from competing with sugar.

5.7. The quota system has thus produced the opposite result to what was initially planned. If we consider that it is principally the nationalization of the quotas which has made this instrument ineffective, and even counterproductive, we must conclude that a production management policy based on a system of production quotas, especially when price conditions are generous (see paragraph 5.11), is bound to fail if it takes the form of quotas defined for and managed by each Member State and then perpetuated indefinitely, de facto if not de iure, as can be seen in the case of sugar.

5.8. The system thus implemented has allowed the common sugar market to reach a rate of oversupply of as much as 173 %, and around 150 % on average for the last ten years. This market thus boasts the greatest surplus of all the common agricultural markets. Given that this surplus has to be disposed of on the world market, where the level of prices averages roughly half of the guaranteed Community price — a particularly unfavourable ratio — and that around two-thirds of these exports receive refunds to make up for this difference, the result is an extremely expensive mechanism, particularly in relation to other markets. The truth is that sugar beet sowing in the Community could be reduced by a minimum of 20 % at no risk to the internal market supply. This situation is far from the principle of economy which — the Court is bound to point out — is an integral part of sound financial management.

5.9. One of the objectives that the creation of a common market is supposed to achieve is regional specialization. It has to be observed that this has not been achieved, for the following reasons:

a) in the first place, national quotas have been allocated, with each successive enlargement, to countries which were not all equally suitable for beet cultivation, so that they have each become more or less self-sufficient in sugar. From the very beginning, certain measures included in the basic regulation and perpetuated thereafter, such as derived prices, mixed prices and national aids, have made up for a lack of economic efficiency on the part of the national producers concerned;

b) originally, the B quotas, as specialization quotas, were by nature essentially mobile (the term 'migratory quotas' was used). On the one hand, they have been gradually nationalized, and, on the other, the levy intended to finance their exports has stopped being selective. The fact is that the institutional price is so generous that B sugar is produced even in the regions which are least suited to beet sugar production and the collection of differentiated A and B levies, in varying proportions from one Member State to another, amounts to a mechanism for the distribution among the Member States of the costs that arise from exports of quota sugar. B sugar can be produced with almost the same confidence as A sugar.

5.10. In actual fact, C sugar is the one that has become the real focus for specialization. This non-quota sugar, which receives no Community guarantees and must be sold on the world market at world market prices, is produced in quantities far in excess of the level of variations which can be attributed to weather conditions. This production cannot fail to have budgetary consequences. In fact, the volume of C exports helps to depress the world price and, thus, tends to increase the rate of the export refund: these exports therefore increase the cost of exports of quota sugar. Furthermore, when the world rate is favourable, producers give preference to exports of C sugar, to the detriment of quota sugar. The combined financial effect of these phenomena amounts to several tens of millions of ECU a year, which have to come from the Community budget.

5.11. The extent of C sugar production and exports can only be explained by the level of return obtained from quota sugar production, thanks to generous institutional price conditions. Further advantages are obtained from specific measures, such as the right to carry over part of the C sugar to the following marketing year as A sugar and receive a storage allowance on the stocks concerned. In the current market situation, these facilities are no longer economically justifiable.

5.12. It is clear from the preceding paragraphs that the current guarantee level (quantities and prices) is too high. The B quotas are seen as self-financing export quotas when, in fact, they amount to a surplus which ought to be competitive on the world market without the need for aid. In this way the Court considers that the overall amount of guaranteed quantities could be reduced. A large part, and even the totality, of the B quota could be treated on the same basis as C sugar is at present, although there would still be a distinction in terms of the level at which the levy would be set, and therefore one of pricing between A and B within this reduced amount. This would allow production to be guided geographically towards an economic optimum, while the disposal costs, similarly reduced, could still be financed.

5.13. In sharp contrast to the remarkable oversupply of sugar, the supply of the alternative, cereal-based sweetener, in the form of isoglucose, has been frozen at a mere 2 % of the maximum quota. Technically speaking, about 25 % of sugar consumed could be replaced by isoglucose. The Court also notes that, while the countries of the South are more suited to the production of high-quality cereals than to sugar beet growing, they are slow to explore this interesting possibility.

5.14. Around one third of the Community's raw sugar exports, or 1,5 Mio t., is intended to balance out preferential imports of raw cane sugar, the bulk of which comes from the ACP countries. While this practice could originally be explained by the existence of a refining industry in the United Kingdom and Portugal when they joined the Community, it is harder to justify in the long term, particularly since the Community A quota, on a par with which this ACP sugar is put for guarantee purposes, is still sufficient to meet the Community's domestic consumption needs. To the extent that this aid for the production of ACP sugar is in the nature of development aid, it ought to be treated as such in the budget. Furthermore, if this aid must be for sugar specifically, the Court wonders whether a simple price guarantee system could not be set up for producers in the ACP countries concerned, thus obviating the costly physical to-ing and fro-ing of the product itself.

5.15. In view of the relative importance of Community sugar exports on the world market, accounting for around one quarter of the market as a whole and around one half of white sugar, the impact is undeniable. The depressive effect constitutes an advantage for the often poor importer countries which obtain their supplies on this market, but it is also an economic obstacle for the producer countries, particularly the developing countries, which are sometimes greatly dependent on this kind of production in their attempts to find profitable export outlets. A re-examination of the system would seem to be indicated, in the context of the current discussions with its trading partners in the Uruguay Round.

### *Substantial costs*

5.16. The characteristics of internal or external macroeconomic management generate substantial costs for the Community finances and for the consumer:

a) the very high cost of the structural surplus supply (corresponding to more than one third of the value of internal consumption), is a burden both on the budget and on the final consumer;

b) the budgetary cost of the preferential imports is, in the Court's opinion, an unnecessary burden on the appropriations for the Common Agricultural Policy;

c) the specific effects of the production and export of C sugar entail invisible additional expenditure against the Community budget.

To all this must be added the illusion of the so-called self-financing principle, as will be reiterated below.

5.17. Bearing in mind all its constituent parts, the sugar market is relatively simple to control and the administrative organization in place at Community and national level presents a relatively well ordered picture. The management procedures are generally competently implemented, on the strength of relatively reliable data and very regular contacts between Community and national departments. There is nevertheless one major shortcoming. In accounting terms, more specifically where the so-called self-financing mechanism is concerned, the real operation of this, as defined in the basic regulation, and the achievement of its aim, as set out in the recitals to this regulation, are not subject to any ex post auditing, as the principles of sound financial management would require.

5.18. This concept of self-financing, or of 'budgetary neutrality', comes down to the principle affirmed since 1968, but much vaunted since 1981, of the financing of the costs of disposing of the excess of Community production over consumption by production levies. In spite of its apparent simplicity, this concept warrants some qualification:

a) in the first place, this does not mean that the entire Community surplus is covered by this mechanism: part of it is still a structural burden on the budget. This is mainly the cost of exporting the equivalent of the imports, a sum of around 761 Mio ECU per annum. Finally, not including the equalization of storage costs, which is a whole system in itself, 'self-financing' covers just less than one half of the market cost;

b) secondly, the net burden on the budget induced, as with the other CMOs, by the application of the double ECU conversion rate (the agricultural rate for the conversion of the unit amounts and the budgetary rate for entering the financial consequences in the accounts) should be highlighted: it has amounted to around 44 Mio ECU on average over the last six years but has been of the order of 100 Mio ECU over the last two years;

c) lastly, even though part of the costs covered by the production levies is paid by the sugar producers, this cost is passed on to the consumer in the level of the institutional price; the nub of the self-financing system is thus the fact that the consumer, rather than the taxpayer, bears a considerable proportion of the cost of the system: it is perhaps this expedient which sustains the mistaken idea that this market is self-financing, is no burden on the budget, or even costs the Community nothing.

5.19. Beyond these initial observations, the Court's analyses, while revealing that no conclusive reconciliation is feasible within the current system of accounting, nevertheless raise doubts, especially as to the accuracy of the amounts used, and included in the calculation of the levies, as regards the costs of export refunds. Considering the laborious nature of these analyses, on the one hand, and in view of the importance of transparent, verifiable management, on the other, it would be desirable to provide for specific reference to each marketing year in the system for the declaration of revenue and expenditure by the Member States. This can be readily achieved, since the Member States already have this information available for their own management purposes.

5.20. The sugar market, which accounts for 2 000 Mio ECU in the Community budget by way of expenditure in respect of this CMO and about 1 200 Mio ECU in terms of revenue, costs the Community and the consumer much more than it should. This is particularly as a result of non-specialization and over-supply on artificial conditions and is, more generally, the result of the tendency to short-term thinking, national protectionism and optimistic evaluation which has always marked the process of policymaking when the system has come under review and the market has been enlarged. Indisputably, there are lessons to be learned from the past for the next review of the CMO, which is due in 1993, following the two-year extension of the current system on which the Council of Ministers has just decided. The coincidence of the dates is too significant for the Court not to stress its importance — sugar cannot be excluded from the radical changes which the single market calls for.

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 12 September 1991.

*For the Court of Auditors*
Aldo ANGIOI
*President*

# THE COMMISSION'S REPLIES

## GENERAL CONSIDERATIONS

The Commission is pleased to note that the conclusions set out in Part 5 of the Court's report make no mention of any violation of the rules governing the sugar sector or any negligence in their application.

Readers pressed for time may also refer to the Commission's conclusions.

## 1. PRESENTATION OF THE COMMON ORGANIZATION OF THE MARKET

### *The mechanisms by which the system is managed*

**Production quotas**

**1.15.** The Commission would point out that the Member States, when redistributing quotas amongst companies, must take account of the interests of all the parties concerned, and in particular those of sugar-beet and sugar-cane growers, within the strict framework of Community rules. The Commission keeps a watch on how these rules are applied.

**The other aspects**

*Rules on importation*

**1.17.** The Commission would refer to the final figures for Community sugar supply over the production years 1986/87 to 1989/90.

The quantities of sugar imported are shown in the following table.

### *The COM's financial and budgetary system*

**Budgetary nomenclature**

**1.22.** Some revenue and expenditure relating to the sugar sector may be found under budgetary headings other than those mentioned in Table 2 of the Court's report, although such revenue or expenditure is on a smaller scale.

The items concerned are the import levies (Chapter 10 of Title I: Own resources) and the export refunds on sugar used in processed products (Chapter B1-30 of Title B1-3: Ancillary expenditure). The revenue from import levies is estimated at ECU 190 million (B) and the expenditure on export refunds at ECU 180 million (B) (average for the four marketing years from 1986/87 to 1989/90).

The Commission would point out that the costs incurred by the Member States on the collection of sugar levies are charged to the Community budget in the same way as the cost of collecting the Community's other own resources.

**Actual imports from non-member countries**
**(1 000 t white sugar equivalent)**

| | 1986/87 | 1987/88 | 1988/89 | 1989/90 |
|---|---|---|---|---|
| 1. *Raw sugar* | | | | |
| (a) preferential sugar without levy (Protocol No 7 to the Lomé Convention) | 1 370 | 1 421 | 1 330 | 1 263 |
| (b) sugar imported into the Federal Republic of Germany without levy (declaration in the Treaty of Rome concerning FRG/GDR trade) | 25 | 25 | 25 | 41 |
| (c) sugar imported into Portugal at a reduced rate of levy (Portuguese Treaty of Accession) | 154 | 157 | 188 | 281 |
| (d) other imports at the usual rate of levy | 13 | 10 | 18 | 30 |
| | 1 562 | 1 613 | 1 561 | 1 615 |
| 2. *Sugar in processed products* | 207 | 253 | 343 | 313 |
| Total | 1 769 | 1 866 | 1 904 | 1 928 |

These costs therefore appear in Chapter 19 of the revenue part of the Community budget.

The 'remarks' relating to budget heading 1119 were not incorrect but incomplete. The Commission has amended the said remarks in its preliminary draft budget for 1992.

## *The audit's objectives and detailed arrangements*

### The Court's earlier observations

**1.27.** In 1987 and 1988 the Council, acting on a proposal from the Commission and having consulted Parliament, adopted measures for the introduction of an additional levy (known as the 'special elimination levy' for the 1986/87 and 1987/88 marketing years). These measures were in line with the recommendations made by the Court in its 1985 and 1986 Reports.

From 1986/87 onwards the Commission also carried out additional analyses and checks whenever prices or levies were being fixed, to demonstrate clearly that a financial balance was being maintained between the expenditure borne by Community producers and the revenue from the corresponding levies.

In 1989, moreover, following the observations made in the Court's 1988 Report, the Commission began to publish a shortened version of the results in the Annexes to the Financial Report of the EAGGF Guarantee Section.

# 2. THE INTERNAL MACRO-ECONOMIC CONSEQUENCES OF THE COMMUNITY SCHEME

## *Background to the quota system*

### The second sugar regulation and the first enlargement of the Community (1975-1981)

**2.12.** Although it is true that the world market is prone to brief crises, security of supply must be guaranteed at all times, particularly on such a speculative market.

**2.15.** One of the factors taken into consideration when setting the quotas for the new Member States was the traditional level of production over a reference period. The fact that Norway did not join the Community is not, in the Commission's opinion, a good reason for reducing the quota allocated to Denmark for its traditional production of the 50 000 tonnes in question, since the exports concerned are obviously covered by the levies.

### General assessment of the evolution of the quota system

**2.29.** The Commission would point out that the maintenance of the quota system as a means of keeping production under control has in fact limited the quantities which qualify for Community price guarantees. The fact that the Community has allocated the quotas on a geographical basis reflects its determination to maintain a certain level of production throughout the Community and shows its concern for rural society and for the maintenance of optimum farming conditions in all regions. Excessive specialization would have had disastrous consequences for the farming population's standard of living and for rural development in certain regions.

The Commission is relieved to note that, at the time, the 'fathers' of Community agriculture showed concern for rural society and for maintaining optimum levels of agriculture in all regions. In this context, moreover, one must not forget the other aims of Article 39 of the Treaty, i.e. raising the living standards of the farming population in the regions in question, and the consequences which any change of policy would have on rural development. These objectives are as praiseworthy as extreme specialization (which is artificially contrived in some cases).

## *Evolution of market supply conditions*

### The supply surplus

**2.30.** It should be noted that Community white sugar is sold on the world market where there is a real demand that cannot be satisfied, in the short term at least, by other countries.

**Security of supply**

**2.31 – 2.33.** The Commission notes, but does not necessarily endorse, the Court's calculations indicating that the areas sown to sugar beet could be reduced by 20 % without endangering the Community's security of supply. The Commission wonders, however, what other type of farming would replace beet growing if it were to follow up this suggestion and what extra costs this would place on the Community budget if cereals or some other product had to be exported. The Court's statement has to be analysed in the overall context to assess the effects this approach would have on other sectors and on the Community budget.

## *The rational development of production, the distribution of quotas and the attitude taken by the trade*

**Application to sugar beet cultivation and the creation of specialization quotas**

**2.36.** The Community rules on quotas do not cover this new concept of 'migratory B quotas'. Since the outset the B quota has always been linked to the A quota, having been defined as a percentage of the A quota or by reference to B production. If there is to be any 'migration', it would be by the total or partial transfer of A + B quotas between companies.

**The actual distribution of quotas**

**2.37 – 2.38.** The Commission would point out that official prices in the sugar sector, as expressed in ecu terms (A), were frozen for the marketing years 1985/86 to 1988/89 and were actually lowered by 2 % in 1989/90. This policy on prices has to be seen in the general context of support for other agricultural sectors.

The prices applicable in the Community are quite in line with those in other comparable industrialized countries where a support system is in force.

The Commission has of course no objections to a more dynamic policy, even in the southern regions of the Community where specialization is feasible. The Commission should also mention in this connection that it still favours the idea that quotas (established on the basis of reference production rather than consumption) should be allocated directly to undertakings without the allocation of national basic quotas. This was what it proposed to the Council in 1974. See also the reply to point 2.29.

## *The other general provisions affecting economic effectiveness*

**Mixed prices**

**2.39 – 2.43.** The Commission has twice proposed that Member States should no longer be free to apply a system of mixed prices. As it is, such a system has never been followed throughout the Community.

**Regionalized prices**

**2.44.** Contrary to what the Court has claimed, the price supplement in question does not have the effect of encouraging production in the region concerned but that of ensuring a certain minimum level of production.

In the Commission's opinion, Italy is still in structural deficit (as is the Ireland/United Kingdom area), if the quantities of white sugar wich it produces from beet are compared with total consumption in that country. As pointed out in the Commission's proposal for a production quota system as from 1 July 1991 (COM(90) 323 final/2 of 26 September 1990), annual imports amount to approximately 1 200 000 tonnes of ACP sugar, whereas in 1988/89 the quantities produced totalled 1 304 000 tonnes and consumption was running at 2 375 000 tonnes.

**National aid**

**2.47.** The third subparagraph of Article 93(2) of the EEC Treaty states that the Council may, acting unanimously and on application by a Member State, decide that the aid which that Member State intends to grant is to be considered compatible with the common market. This is the procedure which has been followed until now as far as national aid in the sugar sector is concerned.

## *Specific problems in some Member States*

**Restructuring in Italy**

**2.49 – 2.53.** Community policy on sugar production in Italy is a good example of the complexity of factors to be taken into consideration and demonstrates the Community's determination that the optimum level of economic efficiency should not be seen as the sole objective.

## *The situation with regard to isoglucose*

**2.63 – 2.67.** The Commission takes the view that the inclusion of isoglucose in the market organization for sugar was completely justified, bearing in mind that the markets for isoglucose and liquid sugar are closely linked and that the products in question are fully interchangeable. It is out of the question that the Community should give a free rein to the manufacture of isoglucose from basic products which are usually imported from non-member countries without any financial constraint, whereas sugar production is subject to a quota system with the financial responsibility falling on Community producers. This basic consideration has, moreover, been explicitly acknowledged by the Court of Justice in those cases brought before it by isoglucose manufacturers questioning whether they should be subject to a system of production quotas.

The Court has consistently dismissed the actions brought by these manufacturers, ruling that isoglucose quotas were perfectly justified as long as a production quota system applied to sugar (Judgments of 29 October 1980 in Case 138/79 (grounds 26 and 27) and in Case 139/79 (grounds 23, 24 and 26)).

## *Conclusion*

**2.68.** The Commission emphatically disagrees with the Court. The objectives of Articles 39 and 40 go beyond those stated in this paragraph.

# 3. INTERNATIONAL MACRO-ECONOMIC ASPECTS AND THE WORLD SUGAR MARKET

## *The world market*

**The Community's place in the world market**

**3.5.** The Commission would point out that the figure of 12% is based on theoretical assumptions which do not reflect any practical reality.

## *The economic impact of C sugar*

**The relative importance of C sugar production**

**3.8.** The fact that the Community rules allow quantities to be produced over and above the quotas reflect the liberal spirit in which the rules in question were drawn up and which rejected the idea that the production of quantities in excess of those covered by Community guarantees should be prohibited.

**Economic conditions for non-quota production**

**3.13.** Even a manufacturer paying mixed prices would have to restrict his purchases of beet to a level enabling him to make a profit on his production overall.

**The influence of the carry-over mechanism**

**3.14 – 3.15.** The Commission shares the Court's view that the regular carry-over of quantities of C sugar does not reflect the original purpose of the carry-over system for such sugar. That is why the Commission recently proposed to the Council [COM(90) 323 final/2 of 26 September] that C sugar should no longer qualify for the reimbursement of storage costs. As mentioned in the reply to point 5.11, however, this proposal has not been adopted.

**The effect of C sugar on the cost of quota sugar exports**

**3.16 – 3.20.** In addition of the answers given to points 2.31 to 2.33, it should be pointed out that the Court's calculations are based on the assumption that the quantities of C sugar exported by the Community will not be replaced by sugar exports from other countries.

If the quantities of white sugar available on the world market were to fall (as a result of C sugar exports coming to an end), the developing countries to which the Community mainly exports would tend to reduce their consumption. This would also be true if world market prices were high and placed a brake on consumption in these countries. Moreover, the Commission considers that when such white sugar is exported under Community guarantee on a regular basis and in limited quantities, it has in fact a regulatory influence on the supply of white sugar to these developing countries and, consequently, on the market for white sugar, which is quite distinct from that for raw sugar. Another point to remember is that refining capacity is mainly located in the industrialized countries and operates to supply the latter, generally speaking.

The Commission would stress that the effects of C sugar production to which the Court refers derive indirectly from the main objectives pursued. On the one hand, the Community endeavours to implement a responsible export policy by issuing regular invitations to tender which do not give rise to any sudden shifts on the world market. On the other hand, it has to leave scope for production over and above the quotas. As things stand at present, the rules governing the sugar sector must leave scope for such production; otherwise the Court of Justice is bound to find against the rules concerned.

### *The effects of the ACP and Indian sugar protocol*

**3.21.** Most of the observations made by the Court in this part of its report are covered by the replies given by the Commission to point 5.14.

As regards Community expenditure arising from preferential imports, i.e. the export refunds on an equivalent quantity of sugar, the Commission considers that it is in accordance with the financial rules to treat such refunds as expenditure on the agricultural sector, explaining their special nature in the remarks concerning the chapters in question. When faced with the choice between imports and its own production, the Community chose imports in order to meet its commitments vis-à-vis the United Kingdom and ACP countries (cf. Protocols Nos 17 and 22 to the Act of Accession of the United Kingdom).

## 4. THE CONSEQUENCES FOR THE PUBLIC FINANCES OF THE COMMUNITY

### *Development of the budgetary situation*

**4.1.** The Court does not take into consideration the fact that much of the gross expenditure, such as refunds, is attributable to the exportation of a quantity equivalent to the Community's imports of preferential sugar.

The Court's observations, particularly its remarks establishing a link between expenditure and revenue, are at odds with the principle of financial solidarity, which has been acknowledged by the Court of Justice itself (Judgment of 22 January 1986 in Case 250/34, cf. grounds 19, 20, 21, 22, 25, 30 and 32).

### *The costs of the surplus*

**Cost-sharing**

**4.2.** The Court claims that the levies paid by the producers are 'passed on in the prices and thus charged to the consumer'.

The Commission would point out that the levies are charged on production and not on consumption and that the ACP costs, which represent the bulk of budgetary expenditure, are totally unrelated to consumption.

The method for calculating the production levies is based on the identification of that proportion of expenditure which is to be borne by Community producers.

In the Commission's opinion, the approach taken by the Court calls for the exercise of great caution, particularly as regards the way in which imports and variations in stocks affect overall expenditure on export refunds in a given year, as compared with the revenue for the same year.

**4.3.** The Commission would draw attention to the fact that the Court's calculations for each marketing year, as shown in Table 14, do not take account of the difference between the sugar year and the budgetarry year.

The Commission feels that the Court's presentation of the 'self-financing' *arrangements is ambiguous, to say the least.* It lumps together the costs inherent in preferential imports (which are the exclusive financial responsibility of the Community) and those inherent in the disposal of Community production surpluses (which, by virtue of Articles 28 and 28a of the basic regulation are charged solely to the producers via the production levies). Thus, the comparison of the percentages quoted (42% and 58%) is meaningless in the context of the self-financing arrangements for the sugar sector.

**The induced costs**

**4.5 – 4.6.** The Commission would point out that this analysis and the assumptions on which it is based are purely theoretical:

a) The figure quoted by the Court (ECU 1 987 million) reflects gross expenditure, that is, it does not take revenue into account. There is no reason in any case to compare the expenditure on exports with the value of consumption. The two figures are completely independent of each other.

b) The Commission would stress that the collection of production levies from companies necessarily entails costs for the companies concerned. The levies are paid into the Community budget as the Community's own resources, thus ensuring that no financial costs are passed on to the sugar consumer in his capacity as a Community tax-payer.

c) The budgetary cost which the Court identifies as arising from the Community's obligations under the ACP-EEC Protocol on Sugar and under the Agreement with India consists of expenditure on export refunds which must, under the accounting and budgetary rules, be classified as agricultural expenditure. In the remarks accompanying the budget headings concerned, however, the Commission takes care to explain the special nature of such expenditure.

d) The Commission would draw attention to the hypothetical nature of the Court's estimates. In particular, they assume that the Community's exports of C sugar will not simply be replaced by white sugar from another exporting country.

## *Control of self-financing*

**The mechanism**

**4.8.** Bearing in mind the considerable quantities of sugar imported into the Community, particularly under the preferential arrangements, the Commission sees nothing remarkable in the fact that the quantities which have to be exported as a result exceed surplus production under the A and B quotas.

The following table shows the final supply balances for Community sugar over the last four marketing years and clearly indicates what percentage of Community sugar exports is attributable to surplus production under the A and B quotas, as compared with those attributable to imports or the run-down of stocks:

**Exports of Community sugar** (1)
(1 000 tonnes of white sugar)

| | 1986/87 | | 1987/88 | | 1988/89 | | 1989/90 | |
|---|---|---|---|---|---|---|---|---|
| | tonnes | (%) | tonnes | (%) | tonnes | (%) | tonnes | (%) |
| 1. Exports attributable to | | | | | | | | |
| 1.1 Imports | 1 769 | (49,7) | 1 866 | (48,2) | 1 904 | (51,2) | 1 928 | (61,9) |
| 1.2 Run-down of available stocks | 144 | (4,1) | 476 | (12,3) | 165 | (4,5) | 7 | (0,2) |
| 1.3 Production under A and B quotas for the marketing year concerned | 1 644 | (46,2) | 1 528 | (39,5) | 1 647 | (44,3) | 1 180 | (37,9) |
| 2. Total exports | 3 557 | (100,0) | 3 870 | (100,0) | 3 716 | (100,0) | 3 115 | (100,0) |

(1) Excluding C sugar.

**The problem of accounting control and**
**Accounting analysis and**
**The results of the analysis and**
**Assessment of sound financial management in the area of self-financing**

**4.9 – 4.14.** In 1981 when the present rules were being drawn up, the Commission considered the possibility of fixing the production levies on the basis of accounting data but decided that this was not feasible, largely because of the same technical difficulties as the Court encountered in the course of its attempt at accounting control.

With reference to point 4.13(a), the Commission's statistical approach is based on the legislation as it stands. The Commission regrets, therefore, that the Court should have concentrated all its attention on the question of accounting control/assessment. At the same time, it is pleased to note that the Court's audit failed to reveal any irregularity or illegality.

## *Other specific observations on sound financial management*

### Export refunds

**4.15.** The Court finds that the Commission does not always check on the fulfilment of export commitments established when contracts are awarded.

The Commission has no system for this purpose but together with the Member States it operates a system to monitor the issue of licences, thus enabling it to keep track of any operations thought to be abnormal. This is done not only with a view to sound management but also to ensure that the self-financing arrangements function as they should. The surety mechanism and the level at which the surety is set (which depends on the licences issued under individual tendering procedures) have so far been successful in preventing irregular operations.

Since 1968 the tender system, which was the first to be used for market organization purposes, has made it possible to maintain control over the quantities exported.

### Production refunds

**4.16 – 4.17.** The Commission notes the Court's observations.

# 5. CONCLUSION

## *A seemingly coherent system*

**5.1.** Now that the market organization for sugar has been in force for more than 23 years and has undergone many changes (despite appearances), the Commission feels sure that the management and control arrangements for this sector are working very effectively, not only in the Member States and the companies concerned but also within the Commission itself. The rules may be complex but the sugar sector is more complicated than it seems, necessitating rigorous management and strict controls.

Sugar production from Community-grown beet or cane is thus only one of the factors affecting the management of the sugar marketing year, since the volume of sales, whether for internal consumption or for export, is also dependent on the quantities imported, the level of intra-Community trade and variations in stocks. In addition, sugar is not only an agricultural product but also an industrial product, with a market behaviour which reflects this status and which is unlike that of other products covered by a market organization.

**5.2.** The Community rules on competition also apply to the sugar sector. The Commission remains vigilant in this area so that it can, if necessary, take the measures needed to deal with any infringement, as was the case in 1973 (Commission Decision of 2 January 1973, OJ No L 140, 26.5.1973, p. 17).

## *A system adrift*

**5.4.** The common organization of the market in sugar is in line with the principles laid down in the Treaty. Both the Commission and the Council ensure that each individual measure is in line with these principles.

The best proof of the market organization's success has been the introduction of Community financial solidarity with, on one hand, the establishment of the self-financing system (provided for in Articles 28 and 28a of the basic regulation, Council Regulation (EEC) No 1785/81) and, on the other, the compensation system for storage costs, also self-financed (as provided for in Article 8 of the said Regulation).

The Commission takes the view that these aims are generally speaking in line with the objectives specified in Article 39 of the Treaty. It would point out that stabilization measures have always existed in the sugar sector, in the form of production quotas or the self-financing arrangements. The latter, which were first introduced in 1968 and further developed in 1981, 1986 and 1988, are currently applied to ensure, in particular, that over a given year Community producers meet the full cost of the disposal of Community production surpluses.

The supply rate of 150% quoted by the Court takes account of imports, which are by definition *not* Community production. (1)

As far as production under the A and B quotas is concerned, the expenditure entailed by Community surpluses is fully covered by the producers.

5.5. It is true that quotas are set on a regional basis (and are then allocated to individual companies) and that these quotas are primarily administered by the Member States (according to strict Community rules, however). This policy reflects the Community's determination to maintain a certain level of production (by both beet-growers and sugar manufacturers) in all regions of the Community, thus making a direct contribution towards the development of rural society. Such is the Commission's main concern.

5.6 – 5.7. The Commission acknowledges that it would be theoretically preferable if a system of production quotas did not have to be applied but experience has shown the effectiveness of such a system as an instrument for managing the sector and keeping production under control.

The fact that production is continuing in the regions described by the Court as 'less efficient' indicates that the profitability per hectare would still be satisfactory in such regions even if the aid came to an end. Moreover, consideration must be given to the farming aspects of the question and to the socio-economic and political factors. When fixing the quotas, the Community took into account the level of existing production in each region and in the case of Portugal the decisions taken reflect the Community's wish to encourage beet growing, particularly if no other agricultural product represents a suitable alternative, and to avoid a total dependence on imports.

In the Commission's opinion, the quota system must also apply to isoglucose production. Given the similarities between this product and liquid sugar and the fact that for any quantity of isoglucose produced an equivalent quantity of sugar has to be exported, it is only right that isoglucose producers should pay for their share of the 'surpluses'.

The Commission does not feel that prices in the sugar sector are 'generous', especially if one compares the prices applicable in the Community with those in other industrialized countries (there is usually no economic reference point for gauging the prices obtained in the developing countries). This does not mean, however, that the guaranteed prices in the sugar sector should not be reduced.

The management of the sugar necessitates a considerable volume of administrative work, which only the Member States have so far been able to perform. In terms of cost-effectiveness, therefore, the Commission can see no advantage in transferring this work to its own staff. The Commission would also point out that in 1974 it unsuccessfully proposed that quotas should be allocated directly to companies.

5.8. One consistent feature of the sugar sector has been the contrast between total freedom of production, on the one hand, and the quota restrictions on the quantities qualifying for Community guarantees, on the other. Since the self-financing arrangements ensure that producers bear the full cost of the disposal of Community surpluses produced under the A and B quotas and since the producers bear the full cost of any exports of non-quota sugar (C sugar), the Commission fails to see how the present system represents a departure from the principle of economy. Nor can it see the financial need for a reduction in areas sown to sugar beet, a measure which would in any case have serious consequences for the rural economy in the regions referred to by the Court.

5.9. The quotas for the new Member States were based on the customary level of production over a reference period. The Commission would point out that in principle all national aid has been granted for a limited time only, although the time limit may have been extended. Under the present rules there is to be a 30% reduction in authorized aid between 1988/89 and 1992/93.

In the Commission's opinion, the economic efficiency of production represents only one important factor in a complex agricultural policy where the ideal should be the optimization of all the various factors. Mixed prices have never been applied throughout the Community but only in those regions which may be considered most suitable for beet growing (e.g. the Netherlands and Belgium). On two occasions the Commission has proposed that Member States should no longer have the option of a mixed price system, but no action has been taken on these proposals.

5.10. The rule allowing the production of non-quota sugar (C sugar) safeguards the principle that sugar and

(1) If the degree of self-sufficiency is calculated in the usual way, that is, by expressing total Community production as a percentage of internal utilization, the average figure obtained for the Community is 127 % for the first four years of the current quota system (1989/1990: 129 %, 1988/1989: 128 %, 1987/1988: 122 % and 1986/1987: 129 %).

isoglucose may be freely produced within the Community but places the entire financial responsibility on the producer, who is obliged to sell such sugar without guarantee on non-Community markets.

Although largely dependent on the quantities of sugar carried over, exports of C sugar help to stabilize world market prices, since they can be adjusted to reflect price fluctuations.

The Commission does not share the Court's view that sugar exports as such tend to depress the world price. In most cases the Community's exports supply countries which are unable to produce their own sugar. If the production of C sugar was to be scaled down or stopped, this would certainly tend to push the world price upwards in the short term, but in the medium and long term Community exports would of course be replaced by the white sugar supplied by other exporting countries and (who knows?) produced in circumstances every bit as artificial as those obtaining in the Community. During periods when world prices have been favourable, exports of C sugar do not appear to have depressed the world market to the detriment of Community sugar qualifying for an export refund. On the contrary, traders have continued to submit acceptable bids whenever invitations to tender are issued. For these reasons the Commission does not feel that C sugar is indirectly placing an extra burden on the Community budget. If the growing of C sugar beet was halted, other crops such as cereals would automatically be sown in their place, which would have the effect of increasing the expenditure chargeable to the Community budget in the sectors concerned.

**5.11.** Since the production of C sugar depends on world market prices being high and since such high prices are recorded only once every seven to ten years, it can reasonably be claimed that the existence of C sugar has only a marginal influence on the said market.

The Commission recently submitted a proposal whereby C sugar carried over to the following marketing year would no longer have been eligible for the reimbursement of storage costs, but no action has been taken on this proposal.

**5.13.** It is wrong to say that the countries in the south of the Community such as Italy are slow to explore the possibilities of replacing sugar by isoglucose. In the south of Italy there are plans to manufacture isoglucose from a variety of sorghum. The rules governing the sugar sector place no restrictions on the quantities which Italy may transfer from the sugar quota to the isoglucose quota under its restructuring plans. The Commission would raise no objection to such transfers.

**5.14.** The ACP-EEC Protocol on Sugar states that 'the Community undertakes for an indefinite period to purchase and import, at guaranteed prices, specific quantities of cane sugar, raw or white, which originate in the ACP States and which these States undertake to deliver to it.' The Protocol also provides that it is to be implemented 'within the framework of the management of the common organization of the sugar market'. The physical importation of such sugar into the Community is a basic feature of the agreement reached with the ACP countries. If the Court's suggestion were followed and the raw sugar placed directly on the world market, world prices would probably be affected and the Community would be unable to fulfil its commitment, entered into at the time of the 1973 enlargement, to respect traditional patterns of trade.

As regards the budget, the Commission must observe the nomenclature for the classification of budgetary expenditure but it explains the special situation with regard to the ACP Protocol and the specific agreement with India in the 'Remarks' on Chapter B1-11 and in the 'General observations' at the end of Subsection B1.

It should be noted that the budgetary classification of expenditure arising from preferential imports does not prevent their special nature from being acknowledged, e.g. in the Community rules concerning budgetary discipline.

**5.15.** If the Community's sugar exports work to the advantage of the developing countries which import sugar, as the Court claims, it is also true that the Community's commitment to import 1,3 million tonnes each year at guaranteed prices must work to the benefit of those developing countries which export sugar.

## *Substantial costs*

**5.16.** The Commission is unable to agree with the Court's conclusions for the various reasons outlined above.

**5.18.** The Commission does not agree with the Court's conclusions. The budgetary impact to which the Court refers is deduced from Table 15, which is in fact no more than a comparison between the effect of the 'double rate' on expenditure, on the one hand, and on revenue, on the other. Since the revenue from the sugar sector covers the proportion of expenditure charged to Community producers, it is clear that the differences found by the Court are nothing more than the effect of the 'double rate' on the proportion of expenditure which is charged to the Community budget.

**5.19.** The Commission notes with interest the Court's suggestion for changes to the accounting system with a view to checking on the self-financing arrangements and can see no objection to this being done.