



STUDY ON THE ADAPTATION STRATEGIES OF THE SUGAR SUPPLY CHAIN AFTER THE END OF THE SUGAR QUOTAS

Presentation of key findings and conclusions
EG / CDG joint meeting
February 25, 2022

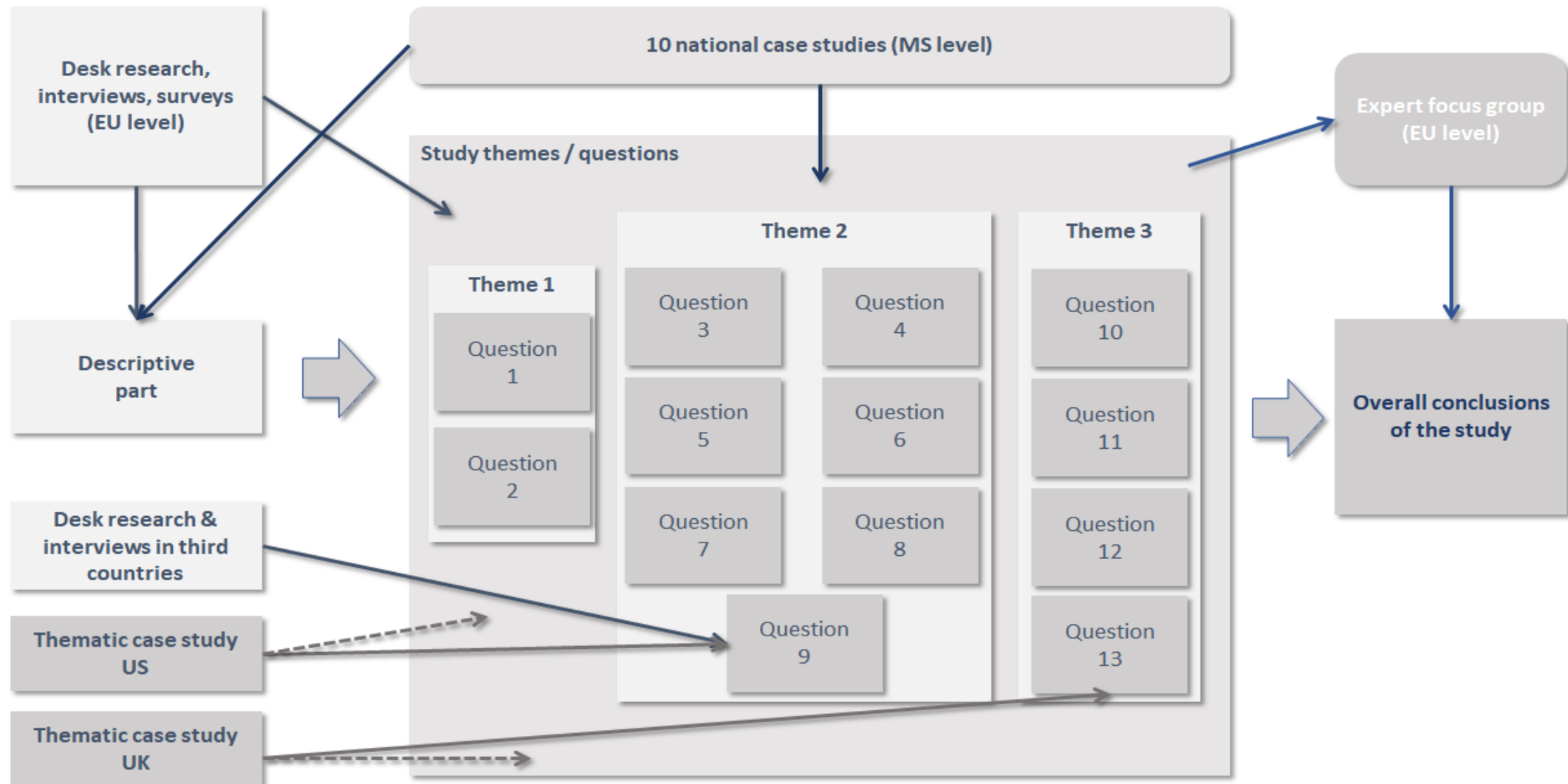


1. Study objectives and study methodology
2. Context of the study: sugar market dynamics in brief
3. Key findings from study themes
4. Conclusions of the study
5. Key developments after the finalisation of the study

Study objectives and methodology

- A sound and comprehensive analysis on the **EU sugar sector's**
 - **capacity to adapt** to its post-quota environment
 - **ability to respond** to varying market and production conditions
- Specific focus on the **consequences of the end of quotas** for the EU sugar sector
- Whether and to what extent the adaptation strategies implemented in the sector ensure an **appropriate level of resilience against current and future threats**, also considering the context of the international sugar market and its developments
- **Suggestions** for strategies aimed at improving the resilience of the EU sugar sector

Overall approach to the study

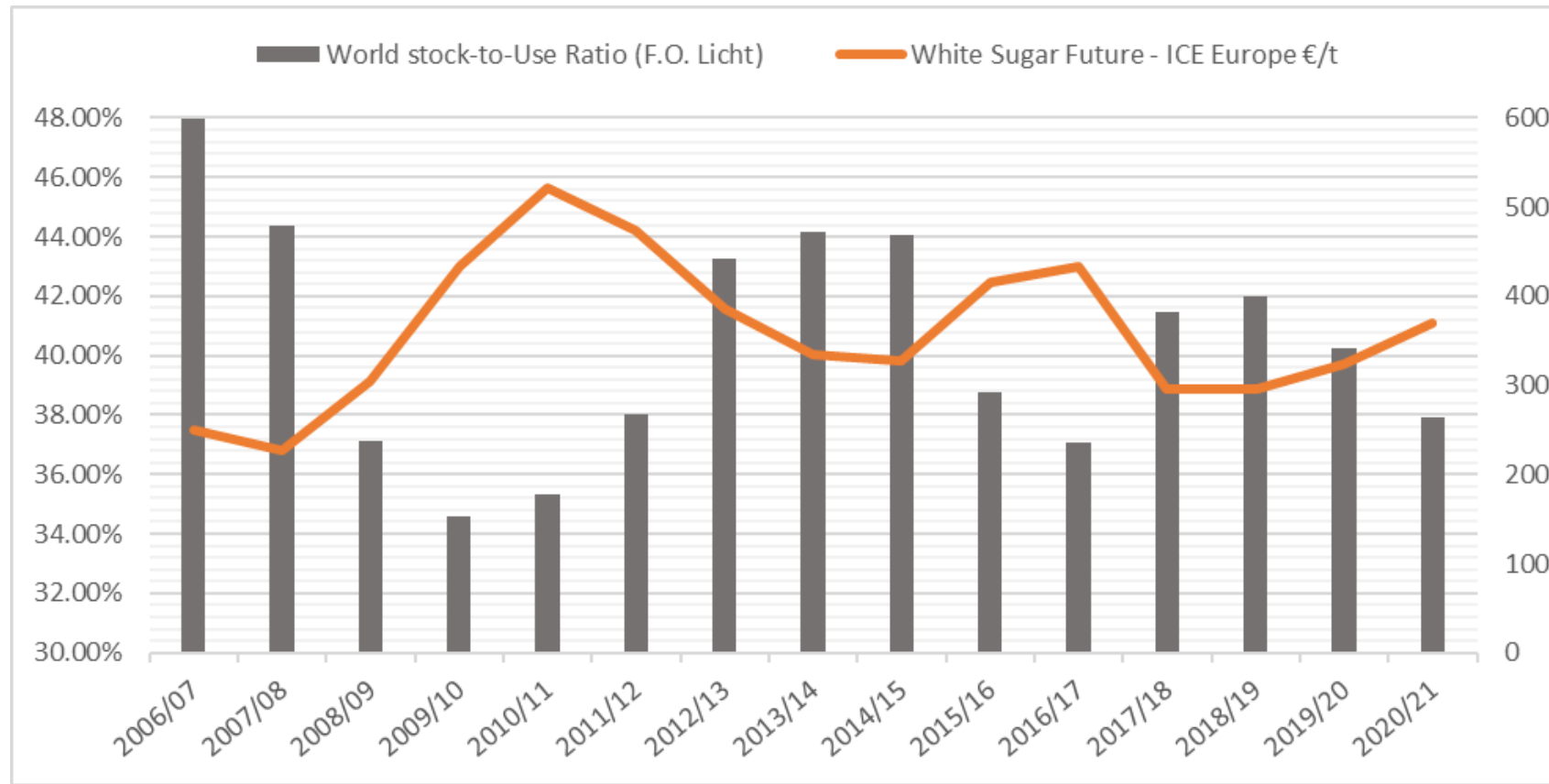


Source: study methodology agreed with the European Commission



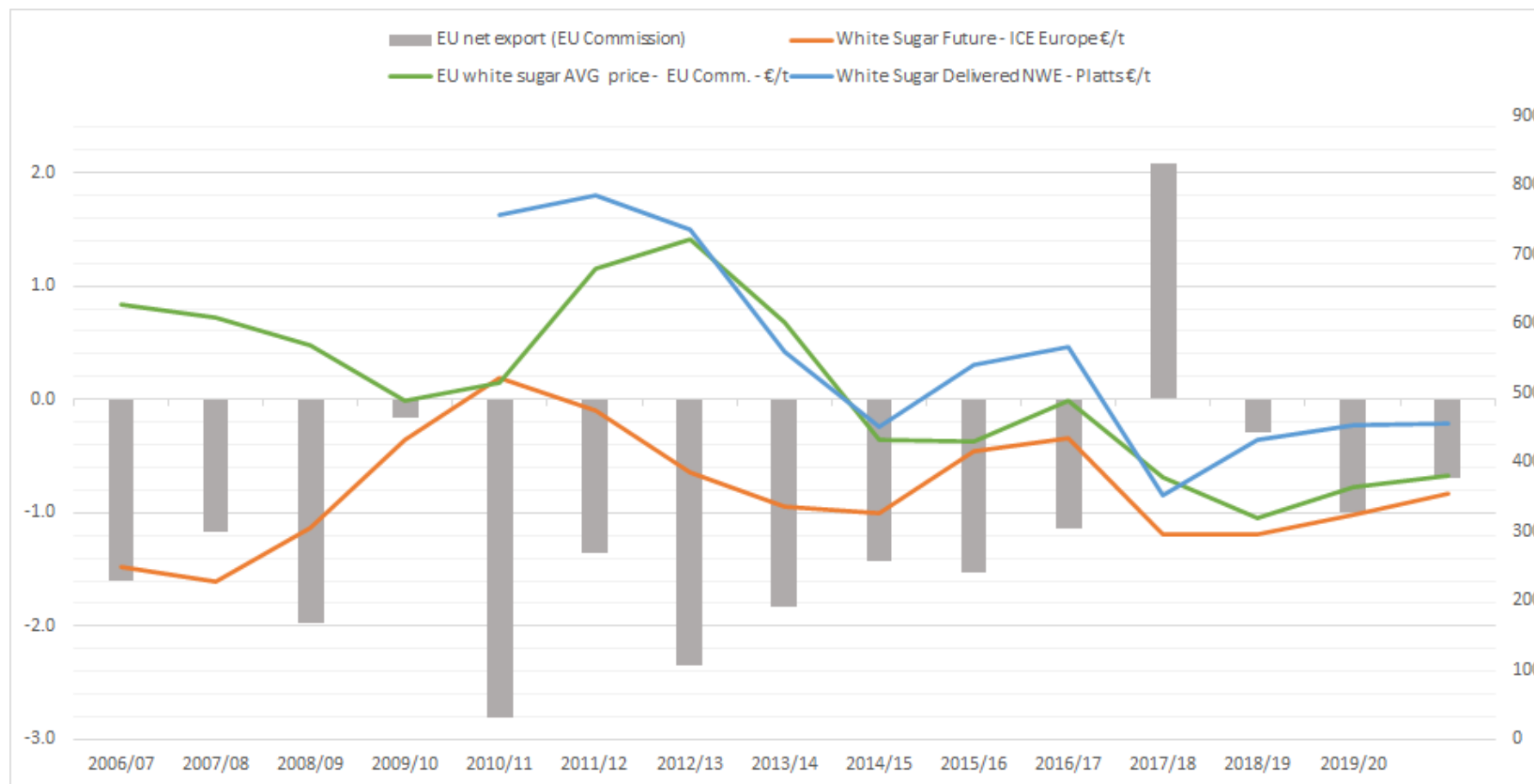
Context of the study: sugar market dynamics in brief

World stock-to-use ratio and international sugar price



Source: Arété elaboration on THE ICE and F.O. Licht – IHS Markit data

EU net sugar exports* and relevant sugar prices



* net exports in million tonnes – left axis

Source: Areté elaboration on THE ICE (white sugar future), EU Commission Sugar Market Observatory (white sugar avg. price) and short-term outlook (net exports), and Platts data (white sugar delivered North-Western Europe - NWE).



Key findings from study themes



THEME 1

**The structure and competitiveness of the
EU sugar sector and its supply chain
organisational arrangements**

Theme 1: key findings

Question 1: What are the main drivers of the EU sugar sector's competitiveness? And, what is their effect (i.e. strengthening or weakening) on the sector's resilience?

Key **technical factors determining productivity** explain only part of the profitability of beet sugar production in the EU → variable effect on resilience

Cost competitiveness in sugar beet farming and processing has **critical importance in terms of resilience**

Combined effect of **size and diversification**: strengthening → effective in **smoothing variations in profitability**

Question 2: What are the supply chain organisational arrangements and the types of contractual relations between the main actors? And, what is their effect (i.e. strengthening or weakening) on the sector's resilience?

Sugar beet supply agreements and contracts: **effective production planning** also in the most difficult phase of the market crisis of the post-quota period; **not always effective in safeguarding the profitability of sugar beet farming** via sugar beet pricing

Multi-annual contracts and arrangements (beet growers ⇔ sugar producers ⇔ sugar users): pros and cons → **trade-off between improved stability and reduced flexibility.**

Balance of bargaining power: influence on relevant **arrangements and contracts** in both the **upstream (beet growers ⇔ processors)** and **downstream (sugar producers ⇔ customers)** parts of the sugar supply chain



THEME 2

The threats to which the EU sugar sector is confronted; the existing risk management strategies, their use and effectiveness

Question 3: What are the main existing risks affecting the EU sugar sector as well as the most important threats expected to occur in the short, medium and long term?

Most of the identified risks (risks related to sugar beet cultivation → yield volatility; risks related to planning of sugar production; risks related to sugar price volatility and to prolonged sugar price depressions) combine **high probability of occurring in the post-quota period** with **high importance** → **serious negative impacts**.

Policy-related threats (voluntary coupled support to sugar beet becoming unavailable, or contributing to market distortions; non-homogeneous implementation of the ban on neonicotinoids; Free Trade Agreements with sugar-producing third countries/trade blocs) perceived as **serious by most sectoral stakeholders**.

Question 4: What are the existing private and publicly funded tools used, as well as strategies/approaches to reduce/mitigate the impact of the identified risks for the EU sugar sector?

Question 5: To what extent the identified risk management tools address effectively the main identified risks? What are their strengths and weaknesses?

Overall judgment on **adequacy** of risk management tools by the majority of **survey respondents/consulted sectoral stakeholders** is **negative** → **substantial gaps in the protection** offered by risk management tools
Diverging views between sectoral stakeholders and the Commission on the effectiveness of **market measures under the Single CMO Regulation** (non applied in the sugar sector after the quotas)

Question 6: What is the level of uptake of the identified risk management tools and to what extent is this level sufficient to manage the main identified risks effectively?

Uptake of certain tools (e.g.: for **sugar producers**, use of futures in hedging techniques; for **beet growers**, insurance tools) **significantly increased** with the transition to the post-quota period

Sugar producers: focus on **product/sector diversification** (rather than geographical diversification)

Market managements tools in the CMO Regulation (aid for private storage; measures against market disturbance; measures to resolve specific problems; derogation from Article 101(1) TFEU under art. 222; safeguard measures under art. 194 and 195): **no application in the sugar sector in the post quota period** because the **conditions for their activation were not met**

High Level Group on sugar (2019): available regular market instruments (e.g., aid for private storage) **mismatched to deal with the specific market situation** experienced during the **transition period** (changing fundamentals, risk of interference with the adaptation process); however, they **could be used in the future**

Amendments proposed in the CAP negotiations (e.g., more clear **triggering mechanisms**; introduction of a **mandatory production reduction scheme** in case of oversupply situations): not retained in the new CMO Regulation → not appropriate to reveal the existence of a crisis; **not in line with CAP market orientation.**

Theme 2: key findings

Question 7: To what extent the overall risk management strategies/ approaches of the sector's main actors address effectively the existing and anticipated risks?

Effectiveness of risk management strategies/ approaches:

Beet growers

Sugar price depression **too severe a test** for collective actions to safeguard farm income; inter-branch agreements & sugar beet supply contracts: not designed for that purpose; effective only in ordinary market conditions

Sugar producers

that **diversified** into other products and sectors and **pursued process/product innovation** strategies fared through the price depression **better than non-diversified producers** heavily focused on sugar production

Replicability of risk management strategies under different conditions:

Beet growers

change production systems to cope with limitations in the use of fertilisers and pesticides; diversify their crop rotations to reduce production and market risks

Sugar producers

less leeway for improving competitiveness through restructuring without some downsizing; further M&A activity → anti-trust concerns; financial constraints to further geographical/product/sector diversification

Theme 2: key findings

Question 8: To what extent the risk management strategies and specific tools implemented by beet growers and sugar producers increase the resilience of the EU sugar sector, and notably the capacity of beet growers to withstand substantial income reduction (or turnover reduction, in case of sugar producers) in the event of cumulative external shocks and adverse market evolutions?

Beet growers: no particular strategy/tool proved effective to prevent/mitigate substantial income reductions *(despite availability of theoretically suitable strategies/tools)*.

Exceptions: positive results of **diversified activities of controlled sugar companies**; non-sector-specific **income support from decoupled direct payments**; payments from **voluntary coupled support** *(in 11 MS only)*

Sugar producers: clear effectiveness of **product/sector diversification** *(preferably not influenced by sugar price dynamics)* and **significant contribution of process/product innovation** to address negative effects on turnover and profitability

Question 9: Are there any successful tools/approaches/strategies implemented by other major players at world level to address the identified risks that would be relevant for the EU sugar sector?

Experience of other major players in the global sugar market *(Australia, Brazil, India; Thailand, USA)*: **no ready-to-use, effective risk management solutions** that would be **rapidly applicable in the EU sugar sector**



THEME 3

**The institutional setting of the market and
EU policy instruments available for the
sugar sector**

Theme 3: key findings

Question 10: What is the effect on the EU sugar sector's resilience of the current regulatory framework at EU and national levels?

Elements of the policy framework	Effects on the economic viability of the main actors in the EU sugar supply chain	Effects on the availability of an adequate sugar supply in the EU
End of the sugar quota system + end of sugar beet minimum price	Indirect effects, in combination with other factors; contribution to reduced margins and profitability for sugar beet growers and sugar producers	<p>At EU level: no remarkable effects (<i>stable sugar beet area and increased sugar production</i>)</p> <p>At Member State level: redistribution of sugar beet area and sugar production across the EU</p>
EU trade policy	No effects on the economic viability of EU beet sugar producers and sugar beet growers (<i>but future FTAs are perceived as a threat to economic viability</i>)	No significant effect on the availability of sugar on the EU market

Theme 3: key findings

Question 10: What is the effect on the EU sugar sector's resilience of the current regulatory framework at EU and national levels?

Elements of the policy framework	Effects on the economic viability of the main actors in the EU sugar supply chain	Effects on the availability of an adequate sugar supply in the EU
Voluntary coupled support to sugar beet	<p>Positive effect on the margins and income of sugar beet growers in the MS granting VCS</p> <p>Positive effect on the profitability of sugar beet growers in the MS granting VCS</p>	<p>May contribute to prevent a reduction in the extent of areas under sugar beets in the MS granting VCS → can help to mitigate negative implications for domestic sugar supply</p> <p>Neutral effect on sugar supply in the EU as a whole</p>
Decoupled direct payments	<p>Positive direct effect on the stability of the income of sugar beet growers</p> <p>No effects on the economic viability of EU beet sugar producers</p>	<p>Neutral effect on sugar supply in the EU</p>

Question 11 How the proposed CAP and other relevant EC initiatives (e.g. Farm to Fork strategy) may affect the current regulatory framework and sector's resilience?

Main expected negative impacts on economic viability of beet growers and sugar producers from:

1. Potential **reduction in pesticide use + end of derogations** for the **use of banned neonicotinoids** in 10 MS.
Horizon Europe: R&D funding to find alternatives to plant protection products → risk mitigating factor.
Effects are difficult to quantify (particularly longer term ones) → **great precaution** in drawing conclusions.
2. Potential **reduction/abolition of coupled support decisions** by 11 MS currently granting VCS on sugar beets (accounting for 30% of the EU-27 sugar beet area and production)

Question 12: What are the main elements underlying the price transparency and price discovery possibilities (including futures markets) specific to the sugar sector, and how does it affect the sector's resilience?

EU sugar market: apparently **lower availability of sophisticated price information** vs. global market & some extra-EU markets (e.g., USA, Brazil)

Polarised and sometimes diverging views of beet growers and sugar producers on:

- **price transparency and price discovery** in the EU sugar market
- **their influence on the resilience of the EU sugar sector**

Starting from January 1, 2021, the Commission can publish **average selling prices for short-term contracts** → improved price information for the **spot market** in the EU

Theme 3: key findings

Question 13: Is there any other element, which influence the current institutional setting of the EU sugar market? If so, present main characteristics and influences on sector's resilience.

Front of Pack labelling and introduction of **nutrient profiles at EU level** → **moderately negative impact** on the resilience of the sugar sector (*similar measures already exist in some Member States*)

COVID-19 → **negative but limited impact** (*resilience demonstrated by the EU sugar sector so far; emergency measures taken at the EU level; €10 billion EU recovery funding available through rural development policy*)

Brexit → **final impact undetermined** (*potentially increased competitiveness of raw cane sugar refining in the UK might put pressure on the EU sugar sector*)

Measures in the bioenergy sectors → **moderately positive impact** (*increased demand for feedstock → supplementary income to sugar beet farming sector*)

Front of Pack labelling, nutrient profiles, Brexit: the Commission deems that the **medium- and long-term effects** are for the moment **very difficult to quantify** → **great precaution** in drawing any conclusion

CONCLUSIONS OF THE STUDY

EU sugar beet growers, beet sugar producers, raw cane sugar refiners: **serious decline in profitability** (*especially in 2018/19 and 2019/20 MY*) → **severe “stress test” for the overall resilience** of the sector.

Economic viability of the **structurally weaker parts of the sector** (*sugar beet growers and processors in Member States with low productivity and high production cost; full-time refiners*) **seriously threatened**.
Serious difficulties even in the **most competitive Member States**.

No massive and widespread casualties in the sector, but:

- some small-sized sugar producers ceased their activity;
- a few mid-sized ones drastically downsized their operations;
- most large-sized multinational groups closed some of their processing plants;
- more and more farmers switched to alternative crops.

The sector as a whole has somehow “weathered the storm” → **overall level of resilience is satisfactory**, but also **remarkably diversified at national level**, and **affected by non-negligible weaknesses** (*more serious in certain country- or company-specific situations*).

Cost competitiveness in sugar beet farming and processing: **critical factor for resilience**.

Negative effects of price depression were felt more intensely: in MS that are handicapped by low productivity and high production costs; by non-diversified sugar producers

Most of the risks identified as relevant for the EU sugar sector combine **high probability of occurring in the post-quota period** with **high importance**, based on the **severity of the related impacts** and/or on the **perceptions of the affected supply chain actors**.

The **main production risks** related to: **planning of sugar production** (*due to yield volatility and variations in the extent of areas under sugar beets*); **sugar beet cultivation** (*due to climatic conditions and pests*).

The **main market risks** related to **sugar price volatility** and **prolonged periods of low sugar prices**; partially linked with end of quotas, have affected all the actors in the sugar supply chain

Policy-related risks from **non-homogeneous implementation of the ban on neonicotinoids**: perceived as **particularly important** (*remarkable negative impacts of viral yellowing on sugar beet yields and overall sugar output*) by sectoral stakeholders, together with **threats from prospective Free Trade Agreements** and from **challenging goals in terms of sustainable farming in the EU set out in the Farm To Fork strategy**.

The **main systemic risks** derive from **variations in the price of the main energy sources** and from **variations in exchange rates** (*Brazilian Real to US dollar*)

Production risks:

- use of specific **farming practices and inputs**; **crop insurance**: effective with **some limitations** (*policy-related constraints e.g. ban on neonicotinoids; coverage limited to specific risks, like hail, droughts, certain pests*)
- **temporary derogations for the use of banned production inputs** (*neonicotinoids in particular*) partly addressed the limitations (*but were granted in some Member States only, with potential distortions*)

Reserve funds and increased recourse to **hedging techniques based on futures and options** helped sugar producers (*especially refiners*) and international traders in **smoothing out variations in turnover/profitability** and in **addressing price volatility**

State aids (*including those falling under the de minimis clause*): broadly considered as risk management tools; improved the resilience of sugar beet growers against **production and market risks**.

Contribution by instruments not designed for risk management:

- **decoupled direct payments** and **voluntary coupled support to sugar beet** (*granted in 11 Member States*)
→ helped stabilising the income of growers and safeguarding the profitability of sugar beet farming.
- **sugar beet supply agreements and contracts** → effective production planning; **not always effective in safeguarding the profitability of sugar beet farming** (*via sugar beet pricing*)
- **price monitoring and reporting systems** → useful indications on general price trends (*mixed views on usefulness to elaborate risk management solutions to address price volatility and market risks in general*)

Contribution by overall business strategies with significant risk management implications:

- **strengthening cost competitiveness** helped to safeguard the economic viability of EU sugar producers;
- **geographical diversification** helped to address production risks; **no use in addressing market and price risks (EU-wide and global crisis)**;
- **product/sector diversification** (*especially if not affected by sugar price dynamics*) helped to smoothen the adverse effects of price depression on the economic viability of EU sugar producers;
- **technical and product innovation** helped to reduce production costs (*farming & processing stages*), and/or to provide additional revenue streams for sugar producers → helped to safeguard the economic viability of sugar production, and to address production, market and policy risks;
- **direct ethanol production from beets**: great potential as supply management tool but **rather limited uptake in the EU (mostly in France)**; **policy-related constraints to more widespread and flexible imple**; **would not be a concrete option in some sugar-producing MS.**

Tools & strategies with **conceptually sound design**, but more or less serious **drawbacks in implementation mechanisms** that have **limited or prevented**, to date at least, **their uptake in the EU sugar sector**

Mutual funds against pest and diseases (production risks): based on the concept of “risk pooling”, successfully implemented in, e.g., Australia & USA

Income Stabilisation Tool (IST): theoretically well-designed tool (based on “risk pooling”) to address sharp variations in farm income, but **drawbacks in its implementation mechanism** → **not adopted in EU sugar sector**

Hedging techniques based on futures and options: generally **not available to EU sugar beet growers** (*but proven effectiveness in addressing sugar cane price volatility for growers in, e.g., Australia*)

Reasonable to expect that – **once the identified drawbacks are addressed** – a **wider uptake in the EU** will allow for a more robust judgment on the **actual contribution to improved resilience of the EU sugar sector** of these tools

Policy instruments in the CMO Regulation: explicitly designed to perform – among others – risk management functions → could – in theory - contribute to increased resilience of the EU sugar sector in crisis situations.

No practical application in the sugar sector in the post-quota period because the **conditions for their activation were not met** → **no concrete elements** suggesting that those instruments **might suffer from specific weaknesses**

Instruments in the CMO Regulation: **perceived by several sectoral stakeholders** as being characterised by a **discretionary application, following a thorough assessment of the market situation.**

Absence of a predictable triggering mechanism: perceived by those stakeholders as a **serious obstacle to the practical implementation of the measures** in the EU sugar sector in the post-quota period

Stability and predictability: important to sectoral stakeholders (peculiar sugar industry business model)

European Commission: emphasis on consistency of risk management measures in the CMO Regulation with the market orientation of the CAP

Dialogue between the parties: possible solution to identify the most suitable tools and strategies to ensure the stability of the sugar sector without conflicting with the general principles of the EU legislation

Any possible future adjustments to those instruments must consider the legal framework for the reformed CAP, the amended CMO Regulation and the market orientation of the CAP

The assessment **did not identify** any risk management tools and adaptation strategies, among those available to the EU sugar sector, which are either **affected by evident weaknesses in their design and/or implementation mechanisms**, or **whose ineffectiveness** in addressing the risks faced by the EU sugar sector in the post-quota period was **proven by concrete evidence**

Instruments in the CMO Regulation: no evident conceptual weaknesses + non-application during the crisis → **no concrete evidence** to conclude on their actual effectiveness in addressing the risks faced by the EU sugar sector in the post-quota period → **filed under the “wait and see” cluster** rather than the “*what does not work*” one.

“What works” → core of the “toolbox” to address the most serious threats to short, medium and long-term economic viability of the EU sugar sector.

Possible adjustments (*by sectoral stakeholders for private tools; by the Commission/MS for publicly funded ones*) should address the identified drawbacks in the implementation mechanisms of those tools/strategies.

“Wait and see” → adjustments (*by sectoral stakeholders for private tools; by the Commission/MS for publicly funded ones*) may be needed to address the identified drawbacks in the implementation mechanisms of those tools → improve their practical effectiveness and promote more adequate uptake/implementation.

Wider implementation of diversification strategies (*especially towards sectors/products not influenced by sugar price dynamics*) and **process/product innovation strategies** in the sector may be **constrained by limited availability of financial resources** to sugar producers after the crisis.

Potential solution for sugar producers to overcome the constraints: **development of forms of cooperation** (e.g., joint ventures) among sugar companies or with companies operating in the target sectors (*alternative to the implementation through direct investment and/or acquisitions*).

Potential for **innovation in contractual relationships** along the sugar supply chain – esp. **sugar beet supply contracts** - could be **explored further by sectoral actors**; important role in a more market-oriented sugar regime.

Need to: i) find a common ground through new contractual arrangements between all stakeholders; ii) make risk management a top priority.

Important caveat: there is a thin line, but a real difference, between managing risks and addressing structural weaknesses.

Risk management cannot remedy a lack of competitiveness due to low productivity, high production costs, a declining market power in the food value chain or other systemic problems.

Sectoral actors could play a more proactive role in strengthening their resilience, especially by:

- obtaining access to the multiple tools available at EU level that could contribute to an increased resilience of the sector (*e.g., measures under the second pillar of the CAP that are not, as such, part of the risk management toolkit; funds supporting investment in research and innovation, such as Horizon 2020 and Horizon Europe*)
- participating in different good practice exchange platforms set at national /EU level, such as the European Network for Rural Development (ENRD).



KEY DEVELOPMENTS AFTER THE FINALISATION OF THE STUDY

The study considers the developments occurred up to September 2021

Key developments occurred since October 2021

- The **average price for white sugar on the EU market** (*as reported by the Commission's Sugar Market Observatory*) rose from 408 Euros/tonne in September 2021 to **422 Euros/tonne in December 2021**
- The **Commission's forecast for EU sugar production** in the **2021/22 MY** is set at **15.7 million tonnes** (up one million tonnes from 2020/21).
- **IHS Markit forecast** for the **2021/22 global ending stock-to-use ratio** is set at **37.29%** (the tightest level since 2016/17) → **bullish global market trend**

Thank you for your attention!

Contacts

Areté s.r.l.

www.areteagrifood.com

Via del Gomito 26/4, I - 40127 Bologna
Tel +39 051 4388500 - Fax +39 051 561186