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The EU Sugar Policy and the Sugar Sector of Mozambique

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Abstract

This paper discusses the European Union sugar policy and its impact on the sugar industry in Mozambique. The paper examines the importance of sugar to Mozambique, the foreign investments, export and trade, the rural sector, employment and what effect the EBA initiative has had and will have in the country. The European Union has presented a new reform proposal that will be effective in 2006. The proposal will cut sugar prices with 39 percent. How will this affect Mozambique in 2006? Will the country stand to lose or gain from the reform? The paper presents an analysis of the likely effects of the reform and whether the EU reform is in coherence with the aid policy towards Mozambique, both in the short run and in the long run. Our results imply incoherence between the EU reform and the development goals for Mozambique in the short run.

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List of Abbreviations

ACP	African Caribbean Pacific Countries
CAP	Common Agricultural Policy
CMG	Common Market Organization
EBA	Everything But Arms
EU	European Union
LDC	Least Developed Country
MDG	Millennium Development Goals
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development
ROW	The Rest of the World
UN	United Nations
WTO	World Trade Organization

1. Introduction

The 22 of June 2005 the EU presented the new proposal for reform of the sugar sector. If accepted the new system will be put in place 2006. The current system for the common sugar market in the EU is operated mainly through price support. Today the current sugar price within the EU is three times the world market price. The reform of the sugar sector is a step from price support towards income support in line with the prior reforms of the CAP. The current sugar system keeps the EU market closed from the world market for sugar by a variable import tariff which reflects the difference between the world market price and the administrated price within the EU. The only way that third countries can export sugar to the EU is through preferential treatment.

Through the EBA initiative, which was implemented in the year 2001 / 02 LDC countries have gained increased access to the EU market. This allows LDC's to export a yearly quota of 74 185 tonnes of sugar and receive the high price within the EU. The EBA initiative is not just a preferential treatment agreement but can be considered a form of Official Development Assistance (ODA), in value terms it is the most important of preferential treatments for LDC's (UNCTAD, 2005, s 9). This makes the EBA very interesting because it can be analyzed as a form of aid. Because of the high prices for sugar on the EU market these agreements have been very profitable for developing countries. The EBA agreement is said to be a cornerstone for the development of the poorest countries in the world.

The heavy price support has negative effects on the world market which have made a reform inevitable. Subsidies in the form of price support are more trade distorting than income support and thus hurt third countries more. It encourages overproduction and creates an excess supply on the world market. The quota system of the common sugar market within the EU has failed to keep production under consumption limits. The excess supply pushes down the world market price because the EU sugar producers are able to undersell their competitors due to large subsidies for sales in their domestic market. The aim of the EU sugar reform is to make the sugar sector more competitive and to make the EU stronger in negotiations with WTO.

The reform proposal for the sugar sector will still give preferential treatment to developing countries but the benefits will change. The effects of this reform differ from a long term or a short term perspective. To reach coherence between a reform and the goals set up for the EU aid policy the reform should consider the needs of developing countries. Is the reform coherent with the aid policy within the EU? And how severe are the effects for the LDC's who are now exporting a large amount of sugar to the EU? What positive effects can be expected from the reform and will they make up for the loss incurred in a short term perspective for some countries?

The dilemma for a reform is that the high price within the EU contributes to development through preferential treatments but at the same time encourage over production that in turn hurt third countries export. Is the current sugar reform of 2005 the best solution to avoid these problems and have the negative effects been minimized?

To answer this question we have chosen to analyze Mozambique which has a growing sugar sector in its infancy. Today it enjoys preferential treatment from the EU through the EBA initiative. Mozambique is a recipient of aid from a lot of countries and parts of the Millennium project where the EU has a crucial role. The sugar sector of Mozambique is expanding and is located in the rural areas. The highest concentration of poverty in Mozambique is in the rural areas of the country, thus an expansion means that jobs are created for the poor population. But because of the severe price cut of the reform the government of Mozambique is anxious. It leaves the future of Mozambique in uncertainty. What consequences will the loss of revenues from the reform have on the sugar sector of Mozambique and future foreign investments? What effects will this have on the goals of aid programs that Mozambique is targeted for?

1.1 Disposition

In chapter 2 we will start by discussing the current system for the common sugar market in the EU, and then we will present the reform and examine the world market for sugar. Chapter 3 will analyze the sugar sector of Mozambique and the likely effects from the reform proposal. This chapter includes discussions about the importance of sugar for Mozambique and the structure and development of the sugar sector. Chapter 4 sums up likely effects of the EU policy focusing on the coherence between aid and trade policies both in the short and the long run, and it also discusses what Mozambique needs from the EU reform.

1.2 Purpose

The purpose of this essay is to analyze the effects of the EU reform on a least developed country that enjoys preferential treatments to export to the EU market today. We have chosen to analyze the EBA initiative as a form of ODA and therefore it makes it interesting to investigate the effects of the reform on a country that also receive a large amount of aid for development. This will determine if the effects of the EU reform on least developing countries are coherent with its aid policy for development. We have chosen Mozambique because its sugar sector has a great potential to expand and the EBA initiative has shown to be effective for its development.

2. The EU Sugar Policy

The common agricultural policy (CAP) of the EU was implemented in 1968. It was formed to make the EU self sufficient on agricultural and to develop the agricultural industry. The CAP is based on a system of high tariffs and subsidies. The CAP has resulted in a large excess of supply of agricultural product. It is a big part of the EU budget. There has been three major reforms to make the support to farmers more decoupled, a step from price support towards income support. The sugar sector of the EU is a part of CAP and is called the common market organization (CMO).

2.1 Sugar Production in the EU

Sugar produced in the EU comes from the sugar beet. The climate does not allow for the production of sugar canes but is suitable for sugar beet. The sugar beet contains less sugar than the sugar cane. It is more costly to produce because it requires greater land areas and it contains less sugar than the sugar cane. Holdings with sugar beet are larger in average in terms of both area and economic indicators. If not subsidised the production of sugar from sugar beets can not compete with sugar cane production. The EU sugar regime, with its high guaranteed prices for growers and processors, has also been able to function partly due to the tariff structure that ensure that competition from important sugar producers are controlled for. (The European Sugar Sector).

The EU – 25 sugar production varies around 19 – 20 million tonnes / year and is produced in almost all member states. Sugar production is estimated to be in the hands of 30 companies. The main producers of sugar in the EU are Germany, 21 percent of the production, Italy, 20 percent of the production and France, 14 percent of the production (MEMO 04 / 177). The overall production of sugar in the world 2002/2003 was 135 million tonnes. EU – 25 had a 14 percent share of the production (18, 9 million tonnes of sugar), 12 percent of the consumption, 12 percent of the exports and 5 percent of the imports (The EU sugar sector; 2005).

2.2 Main Features of the CMO

The CMO has not been affected by the previous CAP-reforms and has remained almost unchanged since its implementation in 1968. The CMO operates through heavy price support and a quota system to limit production and distribute it between member states. The CMO are protected from third countries by a variable tariff which leaves it totally closed from the world market except through preferential treatments. 2004 the budgetary expenditure for sugar sector was about \$ 2919 million, where 75 percent of this was export refunds, \$ 2180 million (MEMO 04/177).

2.2.1 The Quota System

The quota system of the CMO for sugar was put in place to distribute the production between member states. It is also a way of keeping the production in line with the consumption of sugar within the EU. But the quota system has failed to put production under the consumption limit and a lot of sugar is exported from the EU. Today the EU is a net exporter of sugar and represents 14 percent of the world export even if the EU producers face some of the highest production costs in the world because of the production of sugar beet, high labour costs and advanced technology.

There are two types of quota produced sugar in the EU, A and B – quota sugar. A – Quota sugar is allowed to be sold at the EU market and the producers receive a price three times higher than the world market price paid by the consumers within the union. The A – quota are to reflect the consumption within the EU. The B – quota represents sugar produced over the consumption limit and are exported to the world market subsidized by the EU. A and B quota represents the maximum quantity of sugar eligible for price support, together 17,4 million tonnes of sugar. The A – quota is 82 percent of this or 14, 3 tonnes of sugar and the B – quota is 18 percent, or 3, 1 tonnes of sugar. (The EU sugar sector; 2005). Additional amounts of sugar produced over the A and B quotas have to be exported to the world market and are not eligible for price support. Sugar produced over the total quota is called “C – quota sugar”, but

is not a part of the total subsidised quota. If not sold on the world market additional amounts can be stored over the year and sold as a total quota accounted for the next year.

The quota system allows the European Union to decide where the sugar should be produced. The purpose is to spread the production all over the EU and not just to the countries that are the most competitive. One of the biggest problems with this system is that the most effective producers do not have the possibility to expand and take advantage of lower production costs due to the average cost falling when production is controlled.

The B – quota represents 3.1 million tonnes of sugar, an amount that is exported and sold on the world market through subsidies. But the total export of sugar from the EU is nearly 5 million tonnes. 2 million tonnes are the so called C – quota sugar exported without subsidies. The C-quota is under a lot of criticism because it is said to be cross-subsidized. C-quota sugar is produced in the same factories and grown by farmers that receive the high price for the rest of their sugar. The production of A and B quota sugar carry the fixed cost and variable costs of production. C – Quota sugar can then be produced in a profitable way if the world market price exceeds the marginal cost.

2.2.2 The Price Support

There is a minimum price for beet which is the minimum price that manufacturers within the EU have to pay. The price for this is \$ 79, 26 / tonnes of sugar used in A – quota production and \$ 55 / tonnes for sugar used in B – quota production. The intervention price for sugar is \$ 1071, 72 / tonnes of white sugar and \$ 759.37 / tonnes of raw sugar. This price has not been changed since 93/94. The intervention price has hardly ever been used because the prices within in the EU are above this level due to the import tariff that protects the European sugar market. Today the current price is \$ 745, 80 / tonnes

(http://www.europa.eu.int/comm/agriculture/agrista/2004/table_en/331.pdf).

2.2.3 EU Subsidies

Export subsidies have always been a subject for discussion concerning the agricultural trade policies of developed countries. Export subsidies are determined as direct payments or the granting of tax relief and subsidised loans to the nation's exporters to stimulate the exports. Developed countries in the world tend to subsidise their agricultural production and developing countries tend to tax. This is because for developing countries the majority of the population is often engaged in agricultural and the main sector bringing income to the government. Therefore developing countries depend on their agricultural sector for economic growth, both through revenues from export and revenues to the government collected as taxes. Export subsidies in developed countries create an incentive to overproduce which leaves a surplus of production on the world market. (Dominick, 1990)

Subsidies destroy the competition on the market because they make it possible for producers to undersell their competitors. The price for exports from the EU producers on the world market is much lower than prices paid by consumers in their domestic market. WTO definition of dumping is that dumping occurs when the price on the world market is lower than the price on the domestic market. This in combination with the excess supply will press the prices down and take away market shares for developing countries. (Dominick, 1990)

When the sugar regime was developed the purpose was to make farmers of the EU self-sufficient, thus production of sugar was to be equal with the consumption of sugar. But the production of sugar within the EU has made the EU one of the biggest exporters of sugar in the world. Today it is the third greatest exporter and represents 12 percent of the total world export of sugar. The subsidies to the sugar producers were in 2002 1, 5 billion dollars, almost a third of the whole subsidy to the agricultural sector in the European Union. This will leave an average export subsidy of \$546, 39 per tonnes.

http://agritrade.cta.int/sugar/executive_brief.htm.

2.2.4 Preferential Trade Agreements

The high price on the EU market makes it attractive for producers in the ROW. Preferential treatments to the EU market have made the EU the biggest importer of sugar in the world. The largest preferential trade agreement is the African Caribbean and Pacific Countries (ACP) sugar protocol. This was established in 1975. The ACP agreements include 20 countries. The agreement is a commitment from the EU to buy a certain amount of sugar paid for with the intervention price. The price for a tonne of raw sugar is \$ 7557,5 and \$ 744 / tonnes of white sugar. The import sugar quotas are allocated for 1, 3 million tonnes of sugar annually. The quota for sugar is not equally distributed between the countries. In 2003, 22.9percent (over 400 000 tonnes of sugar) of all sugar that was exported to the EU came from Mauritius under the ACP agreement (<http://europa.eu.int/comm/agriculture/agrista/tradestats>).

For some of the ACP countries the export to the EU has been so profitable that all production of sugar is exported and sugar is then imported from the world market to satisfy the domestic consumption.

The EBA initiative includes 50 least developed countries and allows them to export commodities to the EU duty free. Sugar is among these commodities but since the establishment of the EBA there has been a quota for sugar imports.. From 2009 sugar is supposed to be imported duty and quota free. The tariff quota for marketing year of 01/02 was to be equal to 74 185 tonnes of white sugar, for each of the following years the quota amount will increase by 15 percent. The price is the same as for the ACP agreement. The value of imported sugar products from LDC's to the EU-25 2003 was \$ 168.7 million and the value of exported sugar products from the EU-25 to LDC's was \$135 million (<http://europa.eu.int/comm/agriculture/agrista/tradestats>).

The quota allocated for the EBA countries are taken on the expense of the ACP agreement so the total exports to the EU has not increased through this agreement. It was implemented because the ACP agreement was not covered by the Enabling Clause created by the WTO. This clause means that developed countries are not allowed to discriminate between developing countries except to generate more generous preferential treatments towards the LDC's (www.wto.se). This lead to a compromise with the WTO when the Everything But Arms (EBA) agreement was created.

2.3 The EU Reform Proposal

The sugar regime of the EU will expire in June 2006. A proposed reform has been under development since 2002 but in June 2005 the commission presented its final reform. The reform will be in line with the previous reforms of CAP which has been a step from price support towards income support. This will mean a severe cut in prices. The quota system will be reformed as well. The main reasons for the reform except to the current systems expiratory for sugar are:

- The maintained artificial price three times the world market price has been a constant point for criticism both internally and externally and puts a heavy pressure on the EU budget.
- To make the EU more effective in agreement settlements in WTO. The WTO panel has convicted the EU of sugar dumping and demanded a reform from this settlement.
- To cause the sugar sector to step in line with the CAP.

The objectives of the reform should make the sugar sector:

- More competitive
- Protect it from price fluctuations on the world market
- Make it more market oriented
- To provide a fair standard of living for farmers in the EU.

The reform proposal consists of:

- A cut in the intervention price of 39 percent. This will take place within two years starting from 2006. Farmers in the EU will be compensated with 60 percent of the loss in revenues due to the price reduction. The intervention price will be replaced by a reference price. A minimum price will be set for beet growers. Beet growers will be allowed to negotiate the price down to 10 percent below the guaranteed minimum price.
- The sugar quota regime will be extended until 2014/15. The A and B sugar quotas will be formed as one production quota. The new quota system will be valid to 2015. The C – quota amount will be expanded with an additional amount of 1

million tonnes. Because of the similarity of the isoglucose and sugar markets the price reduction will have an impact on the revenues of this market as well. Production of isoglucose needs economies of scale and therefore will be granted an additional quota of 100 000 tonnes / year the first three years starting 2006/07.

- There will be a new system of storage that will be used if the market price falls under the reference price.

The restructuring amount of sugar producers in the EU will be \$ 214, 44 / tonne in 2006/7, \$ 163, 74/ tonne in 2007/8 and \$ 112/ tonne 2008/9. Aid for farmers within the EU will be granted to those who are willing to leave the sugar industry. In year one this will be \$1238, 4 / tonne of quota, falling gradually to \$ 712, 5 / tonne in year four. This aid program will start from first of July 2005 encouraging producers to reform fast.

The support to countries exporting to the EU under the Sugar Protocol will be an amount of 47 million dollars. The support for LDC's that exporting to the EU under the EBA is not formulated. There is no support plan in the loss of revenue because of the price cuts. The LDC organisation has demanded an amount of 585 m dollars for the adjustment to the reform, mainly due to the cut in prices.

(IP05 – 776) (Proposal)

2.4 Likely Effects of the Sugar Reform

2.4.1 on the World Market...

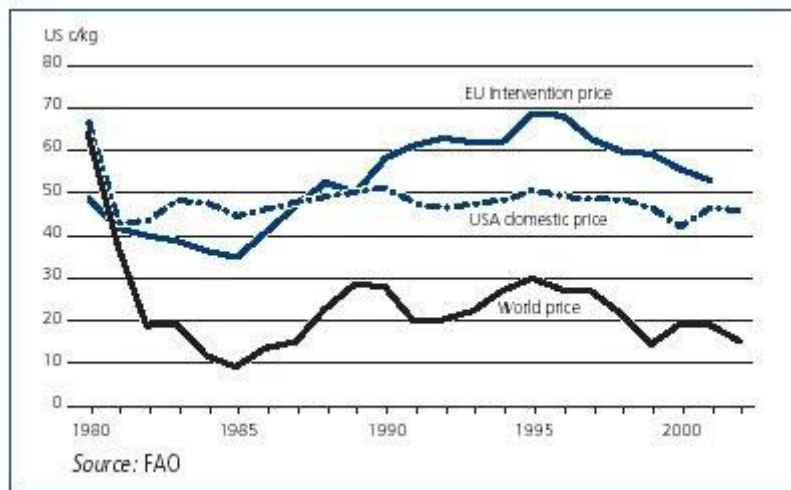
World sugar production is increasing and is expected to reach around 165,131 million tonnes in 2010. The increase of production is concentrated to developing countries where Latin America plays the most crucial role. Among these developing countries are Brazil and Thailand which are the greatest producers in the world today and are expected to grow even more. These are the only two countries that are able to export sugar to the world market price today. Productions in OECD countries are projected to remain the same. The projected consumption in the whole world 2010 is 160.304 million tonnes. (FAO, 2002/Mozambique sugar Conference). The major increase in consumption is also projected to occur in least developed countries.

The world market price for sugar has been depressed for the last 25 years. Remunerative prices are needed if production and exports in developing countries are to be sustained and developed. Because developing countries are dependent on one or few agricultural products for a significant share of their exports the uncertain world price can have devastating effects. In the case of sugar the world market supply and demand depends on policies in OECD countries.

WTO has set up objectives for the sugar policy of most major producing and trading countries to protect the world market price but only a few of these objectives have substantially changed. The tariff reduction of sugar was negotiated on already very high levels. For raw sugar the tariff fell from 93 to 72 percent and for white sugar from 109 to 88 percent. No reduction in support was agreed on sugar although this was likely to have a greater impact on the world market because it reduces the excess supply of sugar. This leave a lot of sugar producing developing countries dependent on market access generated through preferential treatments. The reform of the EU sugar sector is the first step in this direction and because the EU is a great player on the world market for sugar the reform should impose positive effects. The effect on the world market is determined on a long term perspective. Investors are unlikely to have confidence in the world market price because of the history of the sugar

prices. Looking at the long term trend of the world market price it has a history of being depressed:

Figure 2.1: The World Market Price on Sugar



The world market price for sugar has been depressed since 1985. The upwards trend is volatile and has resulted in even lower prices over the time. The future outlook for the prices using the diagram is that it will still be depressed moving with a steady downward slope. The price for sugar in the USA is steadier than the price for sugar in the EU which because of the variable tariffs is allowed to increase with the same proportion as the world market price.

A study that Oxfam has ordered shows that the EU subsidies lower the world market price with approximately 20 percent as a consequence of the excess supply it creates. The World Bank estimated that if the EU market was to be fully liberalized the price of sugar would increase with 39 percent. The EU commission claims that cuts in quota production by the reform will lead to a reduction in the amount of subsidized exports by around 2 million tonnes. This would cause world market price to raise 20-23percent (UNCTAD, 2005, s. 12).

But these are static estimation, looking back at the diagram looking at the dynamic trend the outcome might not be determined by the reduction in production from the EU. The price of sugar follows the trend of other agricultural products which is explained by that of the low income elasticity. When people increase there income the demand for agricultural commodities will be the same.

Another problem with the estimations is that they neglect the fact that Brazil is the largest exporter of sugar today and is almost the only country that is able to sell to the world market price without subsidies. If the world market price goes up, Brazil will always be able to undersell their competitors until prices are pushed down to their production costs. Because sugar production require economies of scale, therefore it would be hard for developing sugar producers to compete with Brazil if they are not given the time to lower their average costs. Economies of scale means that the average cost will fall eventually whilst increasing amounts of sugar is produced. High cost producers today are unlikely to be able to lower there cost because the world market price is to low to make an expansion of the sugar sector profitable.

2.4.2 ...On the Loss in Revenues

The preferential treatments under the ACP sugar Protocol have generated large extra revenues for the countries that can take advantage of the agreement. The EBA agreement has also been very effective and contributed to the development of production in African countries. This is due to the fact that when it was established it created a certainty for the future of the sugar sector in these developing countries, which attracted investors. The agreement has contributed to the development of the sugar sector in Mozambique as well as Zambia, Malawi and Sudan.

Preferential treatment is important for these countries because they can not depend on there domestic markets. The extra revenue that the agreements with the EU generate means reinvestment in the sugar sector. But the investments also mean that the sugar sector of developing countries have become a prospect for investments. The cut in the intervention price of the EU makes preferential treatments like the EBA initiative less profitable.

In a two-year period the price is to be lowered with 39 percent (EU Sugar Reform, s.A10). The static effect is loss in revenues for the sugar exporting countries and will force them to cut back on their production. The price losses will hit all countries that today benefits from preferential treatments. The severity of the effect is determined by the cost of production, other trade agreements and the domestic market.

When the EU market becomes less attractive it could be necessary for the South African sugar producers to flood domestic markets in areas that are not efficient thus high cost producers will be put out of business by the low-cost producers in their region. For example the sugar production of Tanzania is expected to be shut down by Zambia, Mozambique and Malawi which have a much lower cost of production in the area. Mauritius is the country that exports the biggest amount of sugar to the EU through the ACP agreement which has generated a large extra profit. The sugar areas in Mauritius are limited and extra revenues have been used to invest in the sugar sector of developing countries. Mauritius is a high – cost producer and will have the greatest losses in revenues from the reform of the EU which could force their sugar industry to cut back on investment.

Map 1: Mozambique



Map No. 3705 Rev. 5 UNITED NATIONS
June 2004

Department of Peacekeeping Operations
Cartographic Section

Source: UN

3. The Mozambique Sugar Sector – Rise and Fall?

Mozambique is among the poorest countries in the world and has a history of civil war. Since the civil war ended in the 1992 the economic growth has been rapid and steady and around 9percent from the years 1995-2001. During the following years the economic growth has been almost 12percent. But the poverty of its population is still severe. Mozambique has a population of 17 million people where 80percent of the population is located on the countryside. The human development rank of Mozambique is 170 out of 173. 70 percent of the population lives below the poverty line. Economic growth is determined by activity in the services and construction sectors and in a few industries, one of these being sugar. The agricultural output accounts for 27percent of GDP and employees 70percent of the population. One of the most growing sectors since the end of the civil war is the sugar sector which has become a prospect for foreign direct investment and had great impact on the economic and social development of Mozambique. The sugar sector is internationally relatively small but the concentration of economic activity has meant a lot for the economic development of Mozambique (FAO, 2002).

3.1 Importance of sugar

Mozambique is considered one of the few low cost producers in the world. Some of the sugar-producing areas in the world possess the characteristics which automatically make them a low-cost producer. This also implies a highly productive and efficient field, factory and export operation. The main structural constraints facing sugar industries world-wide can be summarised as:

- The ability to continue to increase cane and beet yields
- The ability to mechanise field operations, in particular cane harvesting
- Size structure and ownership of farms
- Security and cost of water in irrigated industries
- Transport related constraints

(FAO, 2002)

The sugar industry of Mozambique is believed to fulfil most of this criteria. Water and land access are good and the local areas of Mozambique has a large pool of unskilled labour. The sugar industry of Mozambique is still in its infancy so the possibility for expansion and sustainable development is therefore great. This means that Mozambique could in the future be able to export to the low world market price profitable if they were to overcome some of the major obstacles for example better infrastructure. Being in its infancy also mean that the sugar sector of Mozambique is sensitive for changes and very delicate in a short term perspective. For this Mozambique needs protection of its infant industry to be able to enjoy the effects from economies of scale and attract more investors to the industry to help the expansion.

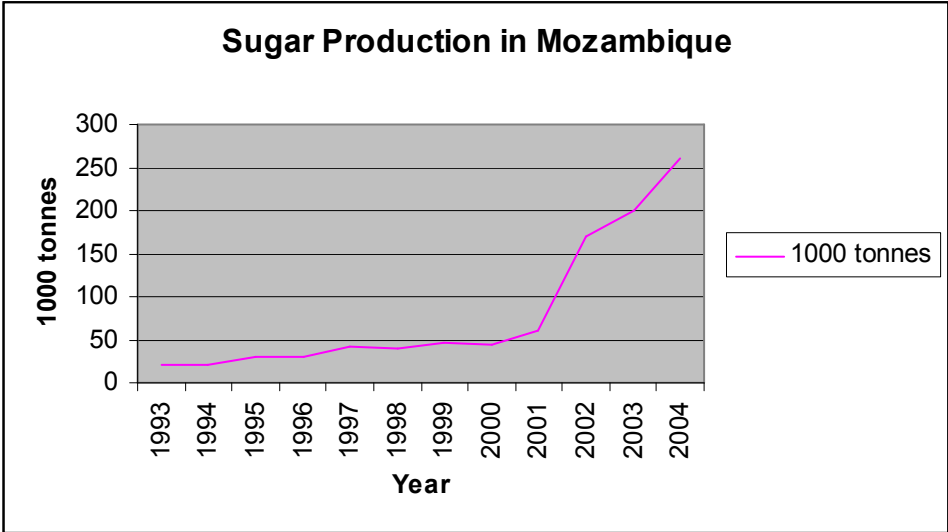
Even if Mozambique possesses these natural comparative advantages in the sugar sector its government is corrupted, institutions are weak and people are poor (<http://mozambique.ms.dk/articles/Widespreadcorruption.htm>). AIDS is a great problem, and the health problems are severe in the country which makes the productivity underutilized. These are characteristics that make Mozambique one of the least developed countries in the world. Despite that the sugar industry is relatively small by international standards it has provided a significant contribution to agricultural production. In the context of Mozambique's limited economy such concentration of economic activity has generated a great amount of revenues, foreign exchange and employment.

3.2 Sugar Sector– Structure and Development of Production

Mozambique has a history of sugar production. The sugar production of Mozambique was at its peak in the 1972/73 when it reached over 325 000 tonnes annually. In the 1980s the production fell significantly due to the civil war which destroyed infrastructure and mills. In 1992 production was at its lowest point ever, producing only 13 000 tonnes of sugar. The rehabilitation of the sugar mills started in the early 90's which was reflected in an upturn of the production in 1997. In 2000 floods undermined the progress of the rehabilitation of the sugar industry.

Looking at the diagram we can see that the production moves slowly upwards between the years 95 to 98. The floods resulted in production standing still in the year 99/00.

Figure 3.1: Sugar Production in Mozambique



Source: FAO

The expansion of the sugar sector can be seen clearly if looking at the year 01/02 when Mozambique was granted access to the EU market through the EBA. From the year 01/02 to 02/03 it took a great jump in production and reached 200 000 tonnes of sugar. Mozambique has been able to multiply their production more than four times from 01/02 to 03/04.

The privatization of the sugar sector and foreign investments have had great impacts on the expansion but also the guarantee of selling to an export market that generates three times the price paid in other markets, i.e. the EU market. A dynamic effect from EBA agreement will then be a sustained increase in the sugar production. It is possible that this process is driven not only by re-investment of financial gains from the EBA at date, but the returns anticipated once duty and quota free access to the EU is granted in 2009(UNCTAD, 2005).

3.2.1 Foreign Direct Investments

It was clear that after the civil war neither the government of Mozambique nor the local entrepreneurs had the scale of investment nor the expertise to rebuild the sugar sector. The solution for this was that when the civil war ended in October 1992 the government started to implement a privatization of industries in Mozambique. For the sugar sector this meant that all the sugar mills in Mozambique were up for sale. It was thanks to the privatization that new capital and specialized management was generated to the sugar industry which was vital for its rehabilitation. There are six sugar mills in Mozambique. These are Maragra, Xinavane, Buzi, Mafambisse, Marromeu and Luabo (Axelsson Nylander & Jonasson, s. 8). Buzi is owned by the Mozambique government, and are not producing any sugar today.

Over the last six years more than \$300 million has been invested in rebuilding the sugar industry of Mozambique (UNCTAD, 2005, s. 58). The investors in the sugar industry are large sugar companies which have substantial experience from the sugar industry. Mainly these are South African sugar companies but also Mauritius sugar companies have invested a significant amount. The investments in the sugar sector have been helped forward by a tariff imposed by the government. This export promotion strategy was to make Mozambique a net exporter of sugar and to protect the infant industry. The protection of the infant industry and the access to markets through preferential treatments is a crucial contribution to the insurance of a market for sugar in Mozambique. Market access is one the most important strategy for investors in sugar industry because the world market is unstable and volatile.

In 2001 the IMF forced Mozambique towards a trade liberalization of the sugar sector which meant lowering these tariffs. But Mozambique was able to go against WTO and keep their level of tariffs because investors from Mauritius and South Africa threaten to withdraw their investment projects which would leave the sugar sector of Mozambique devastated. This shows the importance of investors for the sugar sector realized even by the IMF.

Sugar is today produced in five of these mills, which are all dependent on foreign companies

Table 3.1: Stake Holders in the Sugar Mills of Mozambique

Mill	Stake holder	Country	Stake holders Percentage of the Mill
Maragra	Illova Sugar Ltd	South Africa	72percent
Xinavane	Tongaat Hulett Ltd	South Africa	49percent
Mafambisse	Tongaat Hulett Ltd	South Africa	75 percent
Marrumeu	Sena Holdings Ltd	Mauritius	87,50percent
Luabo (FAO)	Sena Holdings Ltd	Mauritius	75percent

The expansion of production depends on the investments strategies of the sugar companies. South African companies want to keep production in the located area but needs a platform for other exports market. Thus Mozambique functions as a platform for exports to the EU market and the US market. For investors from Mauritius, Mozambique represents an opportunity to invest surplus of capital outside Mauritius because increasing production in Mauritius is blocked by the limited resource of land

<http://statsmauritius.gov.mu/report/hpcen00/census4/intro.htm>).

Mozambique is still dependent of further investments in their sugar industry. All mills need to be rebuilt and an expansion of their productions to reach the benefits of economies of scale. This is because the sugar industry is still defined as being in its infancy. Considering the great production of sugar in the 70th century and the new technology that has been brought to the industry by investors the capacity for expansion is great.

3.2.2 Export/ Trade

The total value of export has risen and is almost \$400 million dollars while the value of imports of goods is between \$1000 and \$1200 million dollars (FAO, 2002). There is a great negative trade balance which leaves Mozambique dependent on aid. Sugar consumption in Mozambique was in 2002 about 110 000 tonnes. But the domestic market for sugar is limited and volatile. There is a lot of sugar smuggled into Mozambique from Zimbabwe. The high tariff for sugar has resulted in 70 000 tonnes of sugar smuggled over the boarder from Zimbabwe (FAO, 2002). The official imports of sugar were 30,400. The exports for this year, 2002, were 55,332 tonnes In 2003 the total of export had increased to 110 000 tonnes. Today Mozambique is a net exporter of sugar. The biggest export market is the rest of the world for Mozambique which represents nearly 71 000 tonnes. But the world market price does not cover the marginal cost for the sugar production.

Because of the uncertainty on the domestic market and the volatile world market price the sugar producers of Mozambique are dependent on preferential treatments. The biggest amount of sugar exports through preferential treatments is from the USA. This agreement allows Mozambique to export to the USA duty-free and receive a price of \$302 / tonnes of sugar. This quota was 13 700 tonnes in 2003 (FAO, 2002) and has not been changed from the previos years.

Mozambique enjoys exemption from the Southern Africa Development Community which allows them to set up a free trade area in the region. This is just a temporary exemption for the protection of the infant industry. Through the SADC sugar can be exported for the price of \$298 / tonnes. The quota is around 13 300 tonnes annually. This quota is determined by domestic production and will rise as the production expand.

The most important preferential treatment is the EBA initiative which gives access to the EU market. The importance of EBA is because the price paid for exports to the EU are \$526 / tonnes This is almost three times the world market price and a lot more than received through other preferential treatments. The extra revenue has made the EBA initiative important for producers in Mozambique. Even if the amount is not a great share of the total exports the extra revenues from the exports to the EU represents a third of export income. In 2002 this

quota was 8 300 tonnes (FAO, 2002) but in 2009 Mozambique will be able to export quota free to the EU.

3.2.3 Effects of the EBA Initiative

When the EBA initiative was implemented it was considered a form of ODA (Official Development Assistance) because the focus was on the least developed countries in the world. It was a way of encourage economic growth in the trade sector of these countries. The key determinant of the development impact of the EBA initiative is the future level of investment that has and can be expected to take place in the sugar industries of Mozambique. For Mozambique all expansion in the sugar sector from the end of the civil war has been due to foreign investments because the government of Mozambique lack capital and skill to do this. The EBA initiative has contributed greatly to further investment in this sector. The most important companies Illovo and Tongaat Hulett have seen great possibilities in the sugar sector of Mozambique thanks to the EBA initiative. But both these companies are great investors in the whole region of South Africa. Their infant investments would have been made with or without the EBA agreement and the further expansion of these companies are more reliant on the future of the world market for sugar. The amount of investments has substantially increased by the future of total market access to the EU. Only 4 percent of their total exports goes to the EU overall today but will expand significantly from total market access (www.huletts.co.za).

On the other hand investments from Sena Holdings which is a Mauritius company can be traced to the EU high prices received within the EU. The sugar companies of Mauritius have made significant profits due to the preferential treatment under the EBA. Their investments abroad are a possibility to use capital overflows because the land resources of Mauritius are limited.

For all further amounts of investments on a short time perspective it is of importance that the EU keep their high price level over a longer period because otherwise the investments will not be paid of. (Axelsson Nylander and Jonasson; 2005).

3.3 Rural Sector

The sugar sector can play a crucial role in fighting for poverty. An expansion of the sugar sector is believed to have a significant effect on employment and therefore an effect on reducing poverty, which certainly will lead to the creation of a sustainable development. In Mozambique sugar has been identified as a key sector for development because of its potential in production and development of their trade sector which will also have a positive impact on poverty reduction. All sugar mills in operation use labour located in the rural areas and are often the only significant employer in the area. They provide an income for the poor population. The sugar industry has a clear positive impact on the immediate surrounding which is noticeable in terms of sugar income stimulating demand for local good and services. The companies that own the sugar estates have put money in the social economic environment and investment to develop this further is planned for.

Maragra are receiving an increasing quantity of cane from small independent farmers. There is also a pilot project at Xinavane to integrate the family sector in which 85 small-scale farmers produce cane sold to the mill (FAO, 2002, s 60). Toongaat-Hulett aims to raise the use of cane supplied by outgrowers from 13.7percent to 53.2 percent which involves both the mill Xinavane and Mafambisse. When farmers have the possibility to grow sugar cane on their own they are more independent from the big sugar companies operating in the industry. For the population in the rural areas this means that they have the possibility to grow sugar which is a cash crop and generate an extra income and at the same time grow maize for their own food consumption on the same land.

Mozambique is one of the least developed countries in the world and the government lack of means to reduce poverty which normally make them dependent on aid. Monetary aid is often not targeted to the poor population because of corrupted and weak institutions. Therefore the sugar companies play a crucial role for the welfare of the population. This also link preferential treatments for sugar exports to the reduction of poverty because they stimulate further investments in sugar sector. While investments are business driven the companies has a power of influence the socio-economic conditions in the area that they invest. Tongaat-Hulett one of the greatest investing companies in the sugar sector of Mozambique has committed resources into health and education in the surrounding area. The groups

involvement in Mozambique has developed the skills needed in the sugar industry and created more than 20000 jobs (www.hulets.co.za/Press-03-06-09). Illova Sugar Ltd owns most of the Maragra sugar mill and invests a yearly amount of \$250 000 into their social-development program (sugar news). Llovo set up housing committees to enable employees to have their own houses and have also provided financial support to local schools.

Investments in social economics generate gains for the sugar companies as well. First of all their labour will become more productive if investments are made in socio-economic factors. But also when investors are increasing developing social programmes to assist the communities in which they are operating they gain public support. For example it was the pressure from investors that made it possible for Mozambique to keep its high level of tariffs which was a great gain for the sugar companies operating in Mozambique.

3.3.1 Employment

The sugar sector of Mozambique occupies 25 000 people and is the most important source of employment (Axelsson Nylander and Jonasson; 2005, s 4). The industries are located in the rural areas because the refinery of sugar cane has to be done as fast as possible. The wages are not high and the working conditions are very hard. Labour employed on the sugar estates earn \$36 / month, and labour employed in the industry earn \$50 / month (Axelsson Nylander and Jonasson; 2005).

The effect on poverty reduction is dependant on how the national policies look like, if they for example can ensure labour standards and environmental standards in the sugar industry. Characteristic for the sugar industry are poor labour conditions, low wages and safety risks. To be able to reduce poverty the government must see to develop a coherent strategy that leads to employment creation, respect for international labour standards and investments in sustainable production. The government of Mozambique has shown great interest in the sugar sector because it actually generates further employment in areas where it is most needed and seem to think that the access to the EU market is the most important contribution to the development of this sector. Because of the positive impact from preferential treatments the

EU are in the position of putting demand on the treatment of labour and affect the lives of the poor rural population.

If the market access to the EU was connected to the Minimum Rules of Treatment of Labour from the ILO it could have a significant impact on the lives of the rural poor. But this connection has to be done with some caution. The demand can not be higher than what it is realistically able to achieve, a minimum wage has to also be economically effective for the company. The union organisation in Mozambique, SINTIA thinks that the benefits from the EBA initiative have to be targeted to the workers and that a social callus which regulates the worker conditions and the salaries are a possible way of doing this (Axelsson Nylander and Jonasson; 2005).

3.4 The Likely Effects of the EU Sugar Reform on Mozambique

The access to the EU market will not be affected by the reform. The sugar quota is still to be removed in the year 2009 which will mean a great increase in access to the EU market but not until a period of 4 years. If exports would be allowed to expand parallel with the reduction in price, a low cost producer like Mozambique could be able to continue to exploit their comparative advantages. The proposal from the EU will mean that there is an 18 – month period when income losses will arise without there being any corresponding increase in the volume of access. For Mozambique the access during this time to the EU market will decrease from their original quota because of the registration of more countries to the EBA agreement. This will make the losses from the price cut severe and probably result in a decrease in production. The sugar sector of Mozambique is in its infancy and the majority of the population is severely poor. This means that the consequences from the reform could be devastating because there is no system of guarantee and complements in Mozambique. Looking at the history of the Mozambique sugar industry it is sensitive to external shocks.

The losses in revenues will be annually and more than 2, 2 million dollars. This is a surplus that otherwise could be reinvested in the sugar industry to cover up the cost of exporting to the world market or assure the social environment of those working in the fields. This can be compared by the amount annually spent by Illovo Sugar Ltd of \$250 000 on social – economic factors. The loss in revenues will force sugar companies operating in Mozambique to cut back on their costs which will mean that further investments in the social economic sector may not be done but rather cut backs will occur even here.

In a long term perspective the supply is projected to fall over time also because at levels of price cut over 39 percent the domestic market is almost always in excess of the EU price. When the domestic market grows, increasing amounts of sugar will be diverted away from the EU market towards the domestic market (LDC Group).

The losses in expected profits due to the price cuts will probably affect future in expansion of the sugar sector of Mozambique. 2003 Toongaat-Hulett expressed their second face of investment in the Xinavane sugar mill which would double the number of hectares and expand the mills capacity to 140 000 tonnes of sugar (www.hulett.co.za/Press-03-06-09.htm). But the EU sugar reform threatens these investments because the profits were calculated with the EU's high remunerative price. Toongaat-Hulett is determined to further invest in the sugar sector of Mozambique but the amount in a short time period will not be the same. They believe that there is a lot to gain from full access to the EU in the year 2009 but expansion of production does not have to occur as rapidly.

The Tongaat-Hulett has the capacity of investing another \$500 million dollars in the sugar industry over the next three to five years (www.hulett.co.za/Press-03-06-09.htm). This would include investments in the aluminium sector as well. But a recent interview with the head of the sugar association after the EU reform presented price cuts of 37 percent expressed his worries that these investments will never take place in the set out time period.

Looking at the history of the sugar sector of Mozambique it has been totally devastated by external chocks which leave the industry completely dependent on the investing companies. The influence of future investment into Mozambique will be the rate of return that the investors require on investments taken in the sugar industry. For Mozambique which is one of the least developed countries in the world the risk for investors requires a high rate of return. The EBA initiative have, because of the high price paid for exports to the EU, been able to generate a high rate of return making up for the risk within the country and the risk of losses from the volatile world market price for sugar. Current investment projects are calculated on the profit received from the EBA exports with the current EU prices.

Another prospect of expansion is the fact that in 2009 when the quota of sugar to the EU market will be removed it will mean no restriction on sugar exports at all. Until then Mozambique is only allowed to export raw sugar to the EU. The future exports of refinery sugar will make Mozambique a prospect for investments in the refinery industry which require a new technology. But investments in new industries and projects have shown to be most sensitive for changes in the EBA agreement. Decisions to invest in new mills is thus determined by the outcome of the reform which is a price cut of 39 percent within two years thus prospects of this kind will be withdrawn (LMC Internaional, 2004). Even if investments and rehabilitation of existing mills will continue there will be no further expansion until the

world market is stabilized according to the FAO. However sugar production requires economies of scale and therefore it is still very profitable to invest in existing capacity.

Mauritius is the second largest country that has expanded their investments in the sugar sector of Mozambique although it is the largest exporter to the EU. The other great investor is South Africa. This can be explained by both the fact that Mozambique is a low-cost producer and has a substantial access to the EU market. The high correlation between increasing production volumes and the activities of foreign investments can be referred to the fact that in 2009 Mozambique will reach quota free and duty free access to the EU market (UNCTAD, 2005). As mentioned above the year 2000 Mauritian and South African sugar producers threatened to withdraw their investments from Mozambique unless the government did not go against IMF rulings to lower tariffs in the sugar sector. They argued that their investments would take ten years to realise a profit at world market prices. Looking at Mauritius their foreign investments are dependent on the EU reform both internal and external. The extra revenues from the sugar sector in Mauritius that are invested abroad in countries like Mozambique will decrease significantly because of the EU reform. The estimated losses from the price cuts for Mauritius are \$95,6 million (UNCTAD, 2005). And then being a low cost producer might not be enough to invest further in the sugar sector of Mozambique. There is a great possibility that for the proceeding of the sugar production in Mauritius which is a high cost producer investments will have to be withdrawn from Mozambique and put in to the domestic production.

Mozambique's minister of industry and trade Antonio Fernando expressed his worries for the planned reform:

"If the EU goes ahead with its reform measures, 30 000 jobs will be threatened in Mozambique," he said.

(<http://www.busrep.co.za/index.php?fSectionId=&fArticleId=2717866>)

The manager of the Maragra sugar company said that if current plans on the price cuts would take place they would have to take corrective action, including reviewing its social-development programmes. (CTA sugar news) The price cuts of the reform will directly affect the poor population in the rural areas if investments like this are withdrawn. The worries of the consequences of the reform were brought forward by affected countries to the UN. George Bullen, chairman of the ACP consultative group said that the EU sugar reform was in the opposite direction of the Millennium Goals because of the effect on the poor population.

"The European Commission's proposals for the reform of the EU sugar regime will significantly undermine the reform efforts of the ACP and LDC's (least developed countries), increase poverty, and wreak havoc on the livelihoods of hundreds of thousands of vulnerable poor sugarcane farmers and their dependants, all of which runs counter to the attainment of the MDGs," (<http://www.ipsnews.net/news.asp?idnews=30265>)

When the prices within the EU falls the access to the EU market will not be attractive. Mozambique has preferential treatments to the US market and South African market as well and it is defined as a low – cost producer. Thus the reliance on the EU market will not determine the survival of the sugar sector of Mozambique, but the short term effects have a severe impact on the employment thus poverty in the local area of the industry.

4. Conclusion

4.1 Coherence in Developing Countries

Coherence is a new concept in aid politics, which means that all policies affecting developing countries within the donor country should work in the same direction. In July 2005 the commission proposed a joint declaration on the European Commission development policy. The proposal notes that the EU has made commitments to policy coherence for development. To reach the millennium goals of development the EU commission recognises that this calls for a substantial additional EU contribution for the fulfilment of these goals (COM (2005) 311 final).

Coherence is far from easy especially when dealing with a multilateral organization like the EU. It is also hard to measure coherence because its complex to overview all policies within a multilateral system. There is a need to determine the impact of specific policies and proposed reforms to understand the importance of coherence. The trade sector is often seen as the engine for growth. An export promotion strategy has historically shown to be very effective for reaching sustained economic growth. Trade is often considered as the main component to economic development and that it can lead to sustainable growth. (Forster & Stokke, 1999). For aid allocations to be effective, aid and trade policies need to be in coherence. If not aid policies and trade policies might pull in different directions, making the aid contribution for development ineffective. Incoherence between trade and aid policies can often reduce the optimal aid policy allocation. When aid is targeted to the trade sector both the trade policies and aid policies from the donor country affect the same sector. This means that the affect that the reform will have on the trade sector will automatically affect the effectiveness of aid targeted for development in this sector.

The EBA initiative is treated as a form of ODA targeted to the least developed countries. It is an important step in the Article 13 of the millennium goals which focus on additional preferential access to the market of OECD countries for commodities from the least developing countries. Thus to reach coherence between the reform of the EU sugar policy and

the goals for the EU aid policy the reform should consider the needs of the least developed countries.

The formulation of the EU coherence policy commits the EU to take into account the needs of developing countries in their reform proposal. Poverty reduction in the world through the MDG project makes it vital to put aid policies in coherence with its trade policies. Coherence with the reform and the MDG means that the negative impacts from the EU sugar reform to recipients' countries are realized and compensated for.

4.2 What Mozambique Needs from a Reform?

"We are looking more for better access to the European markets rather than financial aid. In order for us to compete on the same grounds with producers in Europe, then they have to stop being subsidised,"

Jose Chilengue, Mozambique Sugar Producers Association

Since the discussion concerning the reform of the EU sector there have been formulations of several proposals for sugar reforms that will benefit developing countries. This is important because the aid provided by the EU can be used more effectively if co-ordinated by the recipients themselves. For Mozambique the sugar sector creates job opportunities and generates revenues for the rural population that are among the poorest in the country. A sugar reform that will benefit the sugar sector in developing countries is a direct link to the rural poor.

The proposed reform has three main obstacles, from Mozambique's point of view. These are:

- The need for access to the EU market, not in 5 years but from the implementation of the reform.
- Remunerative prices are needed.
- Stop of sugar dumping as consequences of the intensive support for farmers within the EU for a brighter future of the world market.

For the EU reform to target these needs it has to be able to withdraw the excess supply from the world market. This can be done by a restricted quota for sugar produced within the EU that also eliminates the production of C – quota sugar from the world market. The price cut needs to be put in place during a longer time perspective than the 2 year period, because the 2 year period will incur severe losses in revenues. The market access to the EU can make up for these losses if it was to increase in proportion with the price cuts.

If not the EU are responsible of compensating Mozambique for the losses and to be in coherence with the country's aid policy because the sector affected plays a crucial role for the reduction of poverty. Judging by Jose Chilengue's statement the most important aspect of the EU reform is to ensure Mozambique market access immediately and not in a period of 5 years.

4.2.1 Short Run Perspective

Looking at the short term effect of the reform proposal there is evidence of incoherence between aid allocated to the agricultural sector and the trade sector, an example of this are the price cuts. The effects from the 2 year period price cuts will strike the sugar sector in developing countries that are affected hard. Today these sectors are benefiting from preferential treatments. The sugar sector generates employment for the rural poor and contributes to the socio – economic development. Thus the negative effects will apply to the same population which is target for the aid in the MDG plan. In a two year period these sector will suffer from cuts in cost and production which will incur a cut in both employment and investments in the development of the socio – economic factors.

The full access to the EU market for countries exporting through the EBA initiative will not be put in place until the year 2009. A way of compensating the losses would be to grant these countries full access to the EU in the year 2006 when the reform is implemented. Another way would be to gradually cut the prices because this would mean that there is a period of adjustment for the least developed countries. In the sense of the price cuts of 39 percent the reform works in the opposite direction as aid to the trade sector and the reduction of poverty thus not in coherence with the aid policy.

For the least developed countries to be able to reach a position of being able to compete with low-cost producers like Brazil and Thailand there is a need of protecting the infant industry. The reform will take away part of this protection and the sugar sector of a lot of the least developed countries may not be able to survive.

4.2.2 Long Run perspective

In a long term perspective the EU reform is said to make the world market for sugar more competitive. The EU sugar policy has often been pointed out as the major force for the depressed world market prices and the negative effects on developing countries due to the high subsidies within the sugar sector (www.europa.eu.int).

The reform benefits Thailand and Brazil because these countries have the possibility of exporting to the world market price today due to their low production costs. If the EU reform contributes to that excess supply of sugar, currently being dumped on the world market, is ended, then world market price can be expected to be pushed upwards. South African sugar companies have a bright vision of the future because they believe that the world market will be stabilized in the future. Their investment in the local area will be concentrated to the countries where the production costs are lowest. For Mozambique which is a low cost producer this means that future investments will still take place in a long term perspective but for other African countries the future is not as bright; they will probably be put out of business when the competition tightens. For example the sugar producers of Mozambique and Malawi will in the future flood the domestic markets in their local surroundings. The sugar producers of Tanzania which are high cost producer today might be put out of business when their value of the EU exports disappears.

The sugar production industries are dependent on economies of scale. Sugar production means big investments that will pay off during time which will lower the average cost.

The EU reform is in coherence with the goals of development in a long term perspective if it will manage to withdraw the excess supply from the world market. But the effect on the world market is hard to determine. The historical trend of the sugar prices during the last 20 years has followed other agricultural commodities which prices slope constantly downwards. The

prices for sugar follow other primary commodities for which the income elasticity is inelastic, meaning that when the world income increases the demand for these products will stay the same.

The focus of the EU reform judging from a least developed country perspective should be coherence in a short term period because the effects of the reform on the world market is hard to predict in a long term period.

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