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Sugar Policy Issues

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SUMMARY

Authorized through FY2003 by the 1996 farm bill, the sugar program is designed to protect the incomes of growers of sugarcane and sugar beets, and those firms that process each crop into sugar. To accomplish this, the U.S. Department of Agriculture (USDA) supports domestic prices by making available loans at minimum price levels to sugar processors and by restricting sugar imports. In practice, USDA seeks to administer an import quota in a way that (1) allows only as much foreign sugar to enter the U.S. market as is needed to meet the balance of domestic demand, *and at the same time* (2) results in a market price above the support level which allows processors to pay off any price support loans taken out. The quota is intended to prevent the entry of lower-priced foreign sugar, which if allowed to enter freely, would affect the competitive position of the domestic sugar producing sector.

Record domestic sugar production, combined with imports of sugar permitted under trade agreements or not subject to limitation, contributed to a substantial oversupply in 1999/2000. Since the U.S. government could not further reduce imports to accommodate higher domestic sugar output without breaking its commitment made under World Trade Organization rules, USDA intervened to bolster market prices that had fallen below effective price support levels. Government sugar purchases, and paying growers sugar "in-kind" (PIK) to plow under some of their to-be-harvested crop in order to reduce output, though, did not raise prices enough to enable processors pay back all of their price support loans. Some exercised their right to "forfeit" 10% of FY2000 sugar output, and USDA recorded significant program outlays.

Disagreement over how USDA handled the sugar oversupply situation reflects continued fundamental differences between the growers and processors on one side, and sugar users (primarily food manufacturers) and some cane refiners on the other side, over what U.S. sugar policy should be. Though some program changes were made during 1996 farm bill debate, opponents each year since mounted legislative challenges to modify or eliminate the program. All failed on recorded votes. Program supporters reversed two enacted changes in spending bills.

Lower output in the current marketing season has resulted in some recovery in domestic prices, which are still are low by historical standards. To boost prices, USDA just announced another sugar PIK program. Also, the resolution of specific trade issues will further affect U.S. sugar supply and price prospects. Difficult negotiations to resolve two sweetener disputes with Mexico continue. A recent court decision requires sugar syrup imports entering from Canada to enter under (rather than outside) the sugar import quota.

Affected interest groups will seek to shape future sugar policy as Congress considers a new multi-year farm bill. The sugar production sector has called for resolving trade disputes, retaining the current level of price protection, and relying on marketing controls to control supplies and support prices as the basis for future policy. Program opponents advocate a loan program that provides no price protection, reduces price support levels, and ends the program after the 2004 crops. In upcoming debate, growers and processors will stress the industry's importance in providing jobs and income in rural areas. Sugar users and their allies will argue U.S. sugar policy costs consumers and results in lost jobs at food firms in urban areas.

MOST RECENT DEVELOPMENTS

The U.S. Department of Agriculture (USDA) announced on August 31, 2001, it would again implement this fall a program to pay sugar "in-kind" to growers who agree to plow under a portion of their soon-to-be harvested sugar beet and sugar cane crops. The program's intent is to reduce the government's sugar inventory, reduce its storage costs, and bolster market prices.

An appeals court announced on August 30 that imports of "stuffed molasses" from Canada can enter only under the sugar import quota. Since 1996, such imports had entered outside the quota system, to the dismay of the sugar production sector.

The House Agriculture Committee on July 27, 2001, approved an omnibus farm bill (H.R. 2646) that authorizes a sugar program through 2011, provides the U.S. Department of Agriculture (USDA) with authority to impose controls on the amount of domestic sugar allowed to be marketed, reinstates the requirement that USDA operate the program at no cost to taxpayers, and authorizes a payment-in-kind program permitting the transfer of Government-owned sugar to growers who agree to reduce production. The American Sugar Alliance (growers and sugar processors) commended the Committee for reinstating a policy that "will ensure stable prices for farmers and consumers and operate at no cost to taxpayers." Two House Members countered that the Committee chose to "ignore the failure" of the current program, asserting its proposal "contains no meaningful reform."

BACKGROUND AND ANALYSIS

Brief History of the Sugar Program

Governments of every sugar producing nation intervene to protect their domestic industry from fluctuating world market prices. Such intervention is necessary, it is argued, because both sugar cane and sugar beets must be processed soon after harvest using costly processing machinery. When farmers significantly reduce production because of low prices, a cane or beet processing plant typically shuts down, usually never to reopen. This close link between production and capital intensive processing makes price stability important to industry survival.

The United States has a long history of protection and support for its sugar industry. The Sugar Acts of 1934, 1937, and 1948 required the U.S. Department of Agriculture (USDA) to estimate domestic consumption and to divide this market for sugar by assigning quotas to U.S. growers and foreign countries, authorized payments to growers when needed as an incentive to limit production, and levied excise taxes on sugar processed and refined in the United States. This type of sugar program expired in 1974. Following a 7-year period of markets relatively open to foreign sugar imports, mandatory price support only in 1977 and 1978, and discretionary support in 1979, Congress included mandatory price support for sugar in the Agriculture and Food Act of 1981 and the Food Security Act of 1985.

Subsequently, 1990 farm program, 1993 budget reconciliation, and 1996 farm program laws extended sugar program authority through the 2002 crop year. Even with price protection available to producers, the United States historically has not produced enough sugar to satisfy domestic demand and thus continues to be a net sugar importer.

Prior to the early 1980s, domestic sugar growers and foreign suppliers shared the U.S. sugar market in a roughly 55 / 45% split, respectively. This, though, has not been the case in recent years. In FY2000, domestic production filled 88% of U.S. sugar demand for food and beverage use; imports covered 12%. As high-fructose corn syrup displaced sugar in the United States during the early 1980s, and domestic sugar production increased in the late 1980s, foreign suppliers absorbed the entire adjustment and saw their share of the U.S. market decline.

U.S. sugar policy maintains domestic sugar prices above the world market price. As a result of this price differential, U.S. consumers and food product manufacturers pay more for sugar than they would if imports entered without any restriction. How all sides view this issue undergirds much of the public debate on sugar policy.

Current Sugar Policy

Background

The 1996-enacted sugar program kept intact the broad outlines of prior U.S. sugar policy (with one change), but adopted two new features that were expected to inject some price uncertainty into the domestic sugar market under surplus supply conditions. These changes were intended to make the sugar production sector more responsive to market forces and were at that time accepted by sugar producers as the political price for keeping the basic program intact. Current program provisions apply through the 2002 crops.

The first required USDA to make *recourse* loans available to processors whenever it announces a fiscal year import quota of less than 1.5 million short tons (ST). "Recourse" means processors are obligated to repay the loan with interest in cash, rather than exercise their legal right (under "non-recourse" policy) to hand over sugar offered as collateral in full payment of the loan. If effective, recourse loans provide no price floor to processors, even if market prices fall below specified levels. If USDA announces an import quota of 1.5 million ST or more, *non-recourse* loans (the type of loan available under pre-FY1996 policy) automatically would become available to processors. Non-recourse loans provide a price guarantee to a processor whenever market prices fall below the same specified levels. As the amount of imported sugar projected to cover domestic needs declined in recent years to below the recourse loan trigger level, USDA (facing external pressure and exercising its own discretion) effectively took measures that allowed it to announce a non-recourse loan policy. As sugar oversupply and price prospects worsened during FY2000, the sugar production sector sought and succeeded in having Congress repeal USDA's authority to make recourse loans (Section 836 of P.L. 106-387 – FY2001 agriculture appropriations).

The second change required USDA to impose about a 1 cent per pound penalty on any processor forfeiting sugar to the Commodity Credit Corporation (applicable only when pledged as collateral for taking out a "non-recourse" loan). The CCC is the entity that finances USDA programs using funds borrowed from the U.S. Treasury. This provision effectively reduces the statutorily-set level of price support protection available to processors by one cent. With market prices for raw cane and refined beet sugar below loan forfeiture levels (see below for explanation) toward the end of FY2000 when non-recourse loans came due, processors forfeited just over 12% of 1999 domestic sugar output to the CCC that was placed under loan earlier in the year. To exercise this right to forfeit on these loans, processors paid $18.7 million in forfeiture penalties to the CCC.

Policy Overview

To support U.S. sugar prices, the USDA extends short-term loans to processors and limits imports of foreign sugar. The sugar program, though, differs from the grains, rice, and cotton programs in that USDA makes no income transfers or payments to beet and cane growers. In practice, overall U.S. policy operates to indirectly support the incomes of domestic growers and sugar processors by limiting the amount of foreign sugar allowed to enter the domestic market. This is accomplished by using an import quota — a mechanism that is not an integral part of the sugar program's statutory authority as laid out in commodity legislation, but which operates as an integral part to ensure that market prices stay above effective support levels. Accordingly, USDA's decisions on the size of the import quota affect market prices, and are made to ensure that growers and processors realize the benefits of price support they expect to receive, whether or not loans are taken out.

Price Support. USDA extends price support loans to processors of sugarcane and sugar beets rather than directly to the farmers who harvest these crops. Growers receive USDA-set minimum payment levels for deliveries made to processors who actually take out such loans during the marketing year — a legal requirement. With those processors that do not take out loans, growers negotiate contracts that detail delivery prices and other terms. These loans have at times been attractive to sugar processors as a source of short-term credit at below-prime interest rates.

Loan Rates. The last farm bill froze price support — 18 cents per pound for raw cane sugar and 22.9 cents/lb. for refined beet sugar — at 1995 levels for 7 years. Loan support for beet sugar is set higher than for raw sugar, largely reflecting its availability after processing as a product ready for immediate industrial food and beverage use or for human consumption (unlike raw cane sugar). By contrast, raw cane sugar must go through a second stage of processing at a cane refinery to be converted into white refined sugar that is equivalent to refined beet sugar in end use. Any processor that meets requirements can take out a non-recourse loan at these levels (adjusted by region and other factors).

Effective Price Support Levels. The above loan rates do not serve as the price floor for each type of sugar. In practice, USDA's aim is to support the raw cane sugar price (depending upon the region) at not less than 19.1 to 20.7 cents/lb. (i.e., the price support level in a region *plus* an amount that covers a processor's cost of shipping raw cane sugar to a cane refinery *plus* the interest paid on any price support loan taken out *less* a forfeiture penalty applicable under certain circumstances). Similarly, USDA seeks to support the refined beet sugar price at not less than 23.2 to 26.2 cents/lb. (i.e., the regional loan rate *plus* specified marketing costs *plus* the interest paid on a price support loan *less* the forfeiture penalty), depending on the region. USDA seeks to meet these "loan forfeiture," or higher "effective" price support, levels by limiting the amount of foreign raw sugar imports allowed into the United States for refining and sale for domestic food and beverage consumption. A loan forfeiture (turning over sugar pledged as loan collateral) occurs if a processor concludes that domestic market prices at the time of a desired sale are lower than the "effective" sugar price support level implied by the loan rate.

Import Quota. USDA restricts the quantity of foreign sugar allowed to enter the United States to ensure that market prices do not fall below the above levels of effective price support. The policy objective is to maintain market prices at not less than these levels to ensure that USDA does not acquire sugar due to a loan forfeiture.

Tariff-rate quotas (TRQs) are used as the policy instrument to restrict sugar imports to the extent needed to meet U.S. sugar program objectives. In practice, the U.S. market access commitment made under World Trade Organization (WTO) rules means that a minimum of 1.256 million ST of foreign sugar must be allowed to enter the domestic market each year. While the WTO commitment sets a minimum import level, policymakers may allow additional amounts of sugar to enter if needed to meet domestic demand. In addition, the United States committed to allow sugar to enter from Mexico under North American Free Trade Agreement (NAFTA) provisions. The complex terms are detailed in a schedule and a separate side letter, which lay out rules for calculating how much Mexico can sell to the U.S. market. Under the WTO and NAFTA agreements, foreign sugar enters under two TRQs — one for raw cane, another for a small quantity of refined (including beet) sugar. The Office of the U.S. Trade Representative (USTR) is responsible for allocating these TRQs among eligible countries, including Mexico and Canada. The amount entering under each quota (the "in-quota" portion) is subject to a zero or low duty. Sugar that enters in amounts above each quota is subject to a tariff that declines over time, according to the rate specified in each trade agreement. A prohibitive tariff on above-quota imports serves to protect the domestic producing sector from the prospect that additional sugar enters without any limit.

USDA last September set the FY2001 tariff-rate quotas for sugar imports at 1,500,227 ST. All but 100,000 ST was allocated among 40 countries at that time, leaving about 1.4 million ST eligible for entry. Of this balance, USDA allocated 116,611 ST to Mexico. This amount reflects the U.S. position on the amount that Mexico is entitled to ship to the U.S. sugar market under NAFTA (see **Mexico's Access to the U.S. Sugar Market**). The 1.4 million ST represents about 14% of U.S. food consumption this year.

Program Costs and Receipts. The sugar program recorded $465 million in budget outlays in FY2000, the first significant direct costs of the program since FY1986. These reflected USDA's purchases of sugar and loan forfeitures made by processors, offset by forfeiture penalties paid by processors. For FY2001, budget analysts project the CCC will spend about $15 million to store its sugar inventory. During most of the decade, the sugar production sector paid more than it drew out. For the 1991-99 crops, sugar processors paid a budget deficit "marketing assessment" to the CCC on their sale of sugar produced from domestic cane and beet crops. Imports were not subject to this levy. The $254 million in assessments collected during this period represented the sector's contribution to budget deficit reduction by generating revenues for the CCC.[1] In a policy change that it sought, Section 803(b) in the FY2000 agriculture appropriations measure (P.L. 106-78) effectively prohibits USDA from collecting this assessment in FY2000 and FY2001. This saved sugar processors an estimated $83 million over the 2-year period.

Legislative Proposals and Debate Since 1996

The sugar program compromise enacted as part of the 1996 farm bill did not fully satisfy the three most directly affected and competing interest groups — growers and sugar processors, cane refiners, and sugar users. The *sugar production sector* contended that "recourse" loan policy, when in effect, would result in considerable price uncertainty. It also expressed concern that the forfeiture penalty would effectively result in a reduced level of price support, but indicated that most other provisions were acceptable. *Sugar users* contended that the proposed program offered little change from previous policy because price support levels were not lowered. *Cane sugar refiners* feared that retaining 1995 price support levels will result in the closure of more refineries, and further shrink U.S. cane refining capacity.

Since 1996, sugar users and cane refiners unsuccessfully sought to make changes to the sugar program during congressional consideration of successive agriculture appropriation bills in order to attain their lower market price objective. During the 106th Congress, the sugar production sector succeeded in persuading Congress to drop two farm bill provisions — marketing assessments, and the requirement that USDA make recourse loans to processors under certain conditions.

Those that proposed changes contended that the 1996 farm bill did not "reform" the sugar program by providing a transition to the free market as it did for the other commodity programs. Program opponents maintained that the program continued to benefit a few wealthy growers, kept the cost of sugar high, and supported sugar cane production in Florida with adverse environmental consequences for the Everglades. Members that favored lower sugar price support argued that consumers would pay less for sugar and sugar products, and reduce environmental damage in vulnerable producing areas.

Sugar program supporters countered that the changes proposed would devastate an efficient U.S. sugar industry by driving producers out of business, wreak havoc on industrial users who rely on critically timed shipments of sugar at prices below those found elsewhere in the developed world, and undermine the agreement on sugar policy made in the 1996 farm bill. They asserted that proposed reductions in price support would undercut the seven-year contract that Congress made in the farm bill, exposing producers and processors to unreasonable risk who assumed sugar policy would remain unchanged through 2002. They also argued that food companies would not pass on any savings to consumers if sugar price support levels were lowered.

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[1] The peanut sector still pays a similar assessment; authority to collect an assessment from the dairy and tobacco sectors expired in 1996 and 1998, respectively.

Proposals Offered by Program Opponents

During the 104th Congress, an amendment offered during House appropriations markup in May 1996 that effectively would have capped the raw cane sugar price at 21.15 cents per pound (included in the House-passed FY1997 agriculture appropriations bill - H.R. 3603) was dropped in the subsequent conference agreement with the Senate. Separately, an amendment offered in the Senate in July 1996 to this same measure effectively would have eliminated for most sugar processors the price support guarantee provided by non-recourse loans. This was tabled on a 63-35 vote.

During the 105th Congress, the House in July 1997 rejected on a 175-253 vote a floor amendment to the FY1998 agriculture spending bill (H.R. 2160) that would have required USDA to implement the sugar program on a recourse loan basis in FY1998. The House on June 24, 1998, rejected on a 167-258 vote a floor amendment to the FY1999 agriculture appropriations bill (H.R. 4101) that effectively would have reduced sugar price support levels by one cent per pound.

In the 106th Congress, the Senate on August 4, 1999, tabled 66-33 an amendment to S. 1233 (FY2000 agriculture appropriations) that effectively would have not allowed USDA to administer the sugar program in FY2000. The Senate on July 20, 2000, tabled 65-32 an identical amendment to S. 2536 (FY2001 agriculture appropriations). The House, earlier on June 20, tabled on a point of order an amendment to H.R. 4461 to limit USDA spending to purchase raw or refined sugar in FY 2001 to $54 million, the amount spent on sugar purchases during FY2000.

Sugar Production Industry Changes Enacted

The Senate, in adding a farm aid package to the FY2000 agriculture spending measure (H.R. 1906), included a temporary relief provision to effectively prohibit USDA from collecting the marketing assessment from sugar processors through FY2001, if the Office of Management and Budget determines that the federal budget is in surplus in FY2000. House and Senate negotiators retained this language, but dropped the condition that there be a budget surplus for the prohibition to be effective, in amending the farm aid package in conference (Section 803(b) of H.Rept. 106-354). Signed into law (P.L. 106-78) on October 22, 1999, processors expected to save (i.e., increase their revenues by) $83 million over the 2-year period.

With the marketing assessment scheduled to kick back into effect on October 1, 2001, the sugar sector is seeking to repeal this requirement. A provision to accomplish this was included in FY2001 emergency farm aid package proposals considered by the House and Senate Agriculture Committees (but not enacted), and is found in the House Committee's omnibus farm bill (Section 151(b) of H.R. 2646). An effort to repeal this reportedly is also expected to be made during conference this fall on the FY2002 agriculture appropriations measure.

Conferees to the FY2001 agriculture spending measure (H.R. 4461) added language to conference agreement text (Section 836) striking the recourse loan feature of the 1996-2002 sugar program. Members opposed to adding this provision argued that changes to 1996 farm bill authority should be made in the context of congressional consideration of the next farm bill. Supporters argued that continued low sugar prices and loan forfeitures by processors signaled that the production sector was in need of relief as much as the producers of other commodities that have received farm aid in recent years. Signed into law (P.L. 106-387) on October 28, 2000, this change means USDA has authority only to make non-recourse loans to sugar processors for the duration of current program authority.

Sugar Trade Issues

The United States must import sugar to cover the balance of its domestic needs that the U.S. sugar producing sector cannot supply. Therefore, the implementation of provisions found in trade agreements specific to both imports and exports of sugar, sugar-containing products, and other sweeteners such as corn syrup affects the economic interests of the U.S. sugar production sector, cane refiners, manufacturers of corn sweeteners, and sugar users. These provisions are complex, reflect compromises in U.S. trade negotiating positions and the results of bilateral talks to resolve disputes, and affect in varying degrees the economic interests of all parties with a stake in U.S. sugar policy.

Trade provisions covering sweeteners can affect the domestic sugar supply situation, and in turn, the level of U.S. sugar market prices. Sugar imported under market access commitments made by the United States in the NAFTA and WTO trade agreements, together with some sugar products that are not subject to import restrictions, have added, or could under certain conditions contribute, to a U.S. sugar surplus and pressure prices downward. U.S.-Mexican efforts to reach an accommodation among sweetener industry sectors in both countries is probably the most important issue intersecting with the debate on the sugar program's future. Those interests with the most at stake are the: (1) the U.S. sugar production sector, concerned about the amount of sugar allowed to enter the domestic market under Mexico's access under NAFTA; (2) U.S. manufacturers of high-fructose corn syrup (HFCS), seeking to take advantage of a market opportunity opened under NAFTA to sell to the large Mexican market; and (3) the financially ailing Mexican sugar sector, pressing to expand sales to the U.S. market, in large part because of its concern that domestic sales will increasingly be displaced by the Mexican soft drink industry's import of cheaper HFCS from U.S. corn wet millers. The importance and sensitivity of this matter are reflected in the fact that sweetener issues have been discussed at meetings held by both countries' presidents since the late 1990s, and again during Mexican President Fox's official visit to Washington on September 5-7. For this reason, some Members of Congress closely follow developments, and have sought to influence the direction of these negotiations. Acknowledging the importance of resolving this longstanding bilateral trade irritant and also seeking to secure congressional support for new fast-track ("trade promotion") negotiating authority, U.S. Trade Representative Robert Zoellick has reportedly stated that sweetener disputes with Mexico will be the first issue to be addressed by the agriculture trade negotiator once confirmed by the Senate. Among other sugar trade issues, the issue of "stuffed molasses" imports continues to receive congressional attention.

Mexico's Access to the U.S. Sugar Market

Starting October 1, 2000, Mexico under NAFTA became eligible to ship much more sugar duty free to the U.S. market than the 25,000 MT allowed to enter in earlier years. U.S.

and Mexican negotiators continue to disagree, however, over just how much sugar Mexico actually can export in this and coming years. Their disagreement centers on which version of the NAFTA agreement governs this issue. U.S. negotiators base their position on the sugar side letter (dated November 3, 1993) to the NAFTA agreement that was struck in last minute talks between U.S. Trade Representative Mickey Kantor and Mexico's Secretary of Commerce and Development Jaime Serra Pucha. The side letter was included with other NAFTA agreement documents that President Clinton submitted to Congress together with the implementing legislation. Mexican negotiators instead refer to the sugar provisions of the final NAFTA agreement as concluded in August 1992 and signed by each country's president in December that year.

The side letter effectively places a lower cap on duty-free imports of Mexican sugar into the U.S. market than the ceiling would have been under the original NAFTA agreement. The side letter accomplished this by: (1) redefining the original formula for "net production surplus" – the amount of sugar that one country could ship to the other duty free – to also add consumption of HFCS, and (2) raising, but keeping level, the maximum amount that could enter duty free during the FY2001-FY2007 period. Looking at FY2001, Mexico under the side letter's terms can export its "net surplus" but not more than 250,000 metric tons (MT) of sugar duty free. USDA announced on September 15, 2000, that Mexico under the side letter's formula can sell almost 106,000 MT of sugar to the United States in FY2001. Under the original NAFTA agreement, Mexico (if determined to be a net surplus producer under the original agreement's formula for two consecutive years) would have been able to ship its entire projected net sugar surplus. If this formula were used, some 600,000 MT would have been eligible for entry in FY2001. This issue is expected to be discussed over the next month leading up to a USTR decision on the allocation of the FY2002 sugar TRQ, and may be on the Presidents' summit agenda. Some have even called for renegotiating all of NAFTA's sugar provisions as a way to resolve this dispute and address future concerns.

The U.S. sugar production sector is concerned that a decision not to abide by the side letter would result in a flood of additional sugar into an already surplus U.S. market. U.S. cane refiners urge that Mexican shipments under any negotiated deal be in the form of raw rather than refined cane sugar, so as not to undercut U.S. refining capacity. U.S. manufacturers of HFCS have signaled they want their concern about access to the Mexican market addressed. Looking ahead, the U.S. sugar industry is most apprehensive about the impact of other NAFTA provisions as they take effect. These include over-quota sugar imports (e.g., price competitive in the U.S. market) from Mexico projected to occur in FY2004, and unlimited duty-free imports beginning in FY2008.

Stuffed Molasses Imports

Controversy has surrounded the import by a Michigan company (Heartland By-Products, Inc.) since the mid-1990s of a liquid sugar syrup (i.e., "stuffed molasses"). This product is created from sugar imported at the low world price into Canada primarily from Brazil, mixed with molasses and water, and then shipped duty free to the United States taking advantage of a specific U.S. tariff provision. Using special equipment, this firm extracts sugar from this syrup and reportedly ships the remaining molasses back to Canada where the process starts over again. Concerned that this industrial-grade sugar sold to U.S. food companies displaces sales of domestically produced beet sugar (118,000 short tons in 1999/00), U.S. beet and cane refiners have sought a remedy to block its import. This amount equaled 1.2% of total domestic food use that year. Refiners have argued that stuffed molasses is imported deliberately to circumvent the sugar TRQ, by entering under a tariff line that does not subject it to quota restrictions and high tariffs.

Seeking to "close this loophole," these refiners in early 1998 petitioned the U.S. Customs Service to reclassify imports of the product to subject it to the sugar TRQ. After an investigation, Customs in September 1999 revoked its 1995 classification ruling granted to Heartland, and determined that: stuffed molasses had been "tariff engineered" to take advantage of a favorable tariff provision, and the intent of the sugar quota mandated that this product be part of the sugar TRQ. Heartland filed a complaint against Custom's ruling to the U.S. Court of International Trade (CIT). The CIT in October 1999 ruled that Customs could not change the tariff classification after having initially ruled that the product could enter under the tariff line covered by its 1995 classification ruling. Subsequently, the CIT denied the U.S. government's and beet refiners' motion for reconsideration. In late March 2000, the Department of Justice and the U.S. Beet Refiners Association separately appealed the CIT ruling to the U.S. Circuit Court of Appeals in Washington. This Court held a hearing on this case on February 9, 2001. If the court affirms the CIT ruling, imports of stuffed molasses would continue to enter freely. Under such a decision, analysts expect other companies for competitive reasons to move to set up similar operations to extract sugar from imports of stuffed molasses. If the court overrules the CIT ruling, Heartland (then subject to paying very high tariffs) likely may not continue to operate.

On August 30, 2001, the Appeals Court unanimously ruled in favor of the U.S. Government and the Beet Refiners' Association, upholding the Customs' 1999 ruling that imports of stuffed molasses should be subject to the sugar import TRQ's limits. In its decision, the 3-judge panel stated that the CIT went too far in determining that this product was not foreign in origin and thus not covered by the TRQ. The American Sugar Alliance representing growers and processors applauded the decision, stating it "cuts off one avenue for circumventing the sugar import rules."

Concerned that other firms might move to take advantage of "loopholes," the sugar production sector still plans to seek a legislative remedy, arguing that imports of other sugar mixtures could undermine the domestic sugar sector and add to the sugar surplus. In the 107th Congress, Senator Breaux introduced S. 753, similar to a proposal he offered last year, to classify stuffed molasses and related products in the U.S. tariff schedule as products that fall under a tariff line covered by the sugar TRQ.

Sugar Industry, Market, and Program Developments

Those with a direct financial stake in the outcome of the debate on future U.S. sugar policy include: sugarcane and sugar beet farmers, processors (raw sugar mills and beet sugar refineries), cane sugar refineries, industrial sugar users, foreign countries that export sugar to the U.S. market, corn producers and manufacturers of high-fructose corn syrup, and the federal government.

Congressional debate over sugar policy takes place against the backdrop of structural changes in the industry, historically low sugar prices caused by oversupply, and the inability of policymakers working within the current U.S. sugar policy framework to reconcile the two objectives of protecting the price of domestic sugar (under the sugar program) and also meeting trade agreement obligations that allow foreign sugar to enter the U.S. market.

Structural Changes. Seeking since the mid-1990s to capture the financial benefits associated with operating more efficiently and increasing their market share, two processing firms established a joint refined beet and cane sugar marketing alliance, another company pursued a strategy of expanding horizontally in order to be a major player in both beet and cane sugar refining, and three raw cane mills in Florida integrated vertically by building or purchasing cane refineries to handle their output.

The fall in domestic sugar prices that began in fall 1999 contributed to the emergence of severe financial difficulties for firms operating facilities in the higher-cost sugar producing regions, and the farmers who delivered crop to them. Two beet refining factories in California, and two raw cane mills (one in Hawaii, another in Louisiana), closed their doors over the last year. Others filed for bankruptcy or actively sought buyers for unprofitable operations. Imperial Sugar Company (operating both beet and cane refining operations) filed for bankruptcy protection in mid-January 2001. Part of its recovery plan includes the planned sale of its four beet factories in Michigan to a farmer cooperative by October. Tate & Lyle (a British firm with multiple sugar and corn sweetener operations in North America) recently sold its Western Sugar Company operations in Colorado, Montana, Nebraska, and Wyoming to a newly-formed farmer cooperative, and its Domino Sugar cane refineries in New York City, Baltimore, and Louisiana to Flo-Sun, a Florida-based privately-held firm that harvests cane for processing in its 3 raw cane mills and 2 cane refineries.

Low Sugar Prices and USDA's Responses. Record U.S. sugar production in *1999/2000*, when added to imports of sugar permitted to enter under quota or not subject to any limitation, contributed to a substantial oversupply of sugar in the U.S. market in FY2000, and to the fall in prices below effective price support levels and to the lowest levels seen since 1979. In FY2000, raw cane sugar prices were 17% below the previous 3-year average; refined beet sugar prices were 19% below. Since trade agreement obligations effectively removed USDA's ability to further limit the flow of imports, the sugar production sector sought government intervention sufficient enough to raise prices to avert the forfeiture of sugar pledged as collateral for non-recourse loans processors had taken out. (Forfeiture — handing over sugar to the CCC as repayment for the loan — becomes a financially attractive alternative to a processor if the market price is below the effective support (e.g., loan forfeiture) level when the loan comes due.) USDA responded with decisions to: (1) purchase sugar from cane and beet processors (May 2000) and (2) make "in-kind" payments of sugar to beet farmers who agreed to plow under some of their to-be-harvested crop in order to reduce sugar output (announced in late July 2000). Since both actions did not raise market prices sufficient enough to allow processors to pay back all their price support loans taken out earlier, some exercised their right to "forfeit" to USDA about 10% of 1999/00 sugar output. As a result, USDA recorded significant budgetary outlays in acquiring a substantial amount of sugar (1,090,320 ST, raw value).

Though raw cane prices have risen above loan forfeiture levels in the current *2000/01* marketing year, refined beet prices recently were hovering below their respective levels. In order to reduce storage costs, bolster market prices, and alleviate the sugar oversupply situation, USDA announced in early June and late August 2001 three initiatives to dispose of its sugar inventory. First, it plans to sell up to 100,000 tons of refined sugar to ethanol producers, and to make available for sale another 40,000 tons (split equally between raw cane and refined beet) whenever specified market price levels are reached. As of mid-August, USDA has sold some 7,000 tons of sugar for ethanol; prices still are below levels to trigger sugar sales.

Second, USDA announced on August 31 it would implement a sugar payment-in-kind (PIK) program similar to last year's. It will let growers divert from production (e.g., plow under) part of their 2001 beet or cane crop in exchange for sugar still held in its inventory (currently about 772,000 ST). USDA will make available a total of 200,000 ST to farmers placing accepted bids under this exchange. Each farmer will be limited to receiving a maximum $20,000 value in sugar. The beet sector reportedly favored another PIK program, expecting to benefit from higher refined sugar prices; cane growers (operating much larger farms) did not. Fourteen congressman had earlier urged the Secretary of Agriculture not to move forward to implement this proposal, and called upon her "to use the present sugar industry problems as a call for comprehensive sugar reform in the upcoming Farm Bill debate."

Policy Tension. U.S. commitments to allow foreign sugar access to the U.S. market under trade agreements (particularly under NAFTA's terms, but presently subject to dispute), and under those that may be negotiated in the next WTO Round and the Free Trade Area of the Americas (FTAA), raise a fundamental policy issue. Since the annual increase in U.S. sugar consumption largely reflects population growth, domestic sugar output and minimum import obligations are more than needed to cover demand. The dilemma that policymakers face is who should be allowed to supply the small increase in U.S. demand: domestic producers and processors **or** foreign sellers. The outcome of farm bill debate on the sugar program will to a large degree answer this question.

U.S. Sugar Sector Outlook

Those that favor continued government support of the U.S. sugar production sector, and those calling for a radical policy change, acknowledge USDA's projections of future U.S. sugar supply and demand in formulating their legislative proposals and presenting arguments for a change, respectively. Basing its projection on continuing current sugar policy without change, USDA expects sugar production "to be fairly constant" through 2011 (reflecting trend increases in sugar crop yields, offset by reductions in area planted and harvested due to declining real prices for both sugar crops). U.S. consumption is projected to rise at a slower rate than in the past (135,000 ST, raw value each year), more than the annual average production increase (52,000 ST) in the 2001-2011 period. USDA's baseline projects that imports entering from Mexico under NAFTA will surge in FY2004, reflecting the decline in the tariff on over-quota imports, and then almost triple in FY2009 when Mexico is free to ship all its surplus sugar to the U.S. market. Amounts expected to enter then will more than cover domestic needs. As market prices fall below support levels, the forecast assumes U.S. sugar processors will take advantage of the program's non-recourse feature that allows them to forfeit sugar to the CCC. USDA projects forfeitures will rise noticeably, and that stock levels by the end of the period will increase to record levels that analysts would view as "not sustainable." Reflecting this outlook, the Congressional Budget Office estimates a continuation of current policy would result in CCC outlays of $900 million over the FY2002-11 period.

Sugar Program Proposals

Two very different proposals with respect to the future of the sugar program have been tabled for congressional consideration during debate on the next farm bill. In approving its measure, the House Agriculture Committee proposes a 10-year sugar program that retains current price support levels, modifies other features, and gives USDA two additional powers to exercise to ensure that the program operates at no cost to taxpayers (Sections 151-153 of H.R. 2646). Program opponents again introduced their proposal (H.R. 2081) to allow only recourse loans be made to sugar crop processors, lower price support levels by nearly a quarter by 2004, and prohibit any form of price or income protection for the sugar production sector after FY2005. Opponents plan to challenge the Agriculture Committee's program when the House debates the farm bill in mid-September. For a detailed comparison of these proposals, see the Sugar Program in the CRS Electronic Agriculture Policy and Farm Bill Briefing Book.

House Agriculture Committee's Proposed Sugar Program

The sugar provisions in H.R. 2646 reflect many of the recommendations offered by the American Sugar Alliance (ASA) – representing sugar farmers and processors– in testimony presented the Committee on April 26 and July 18, 2001. As approved on July 27, the Committee: (1) continues the non-recourse loan program for sugar through the 2011 crop year, (2) reinstates the pre-1996 directive that USDA operate the program at no cost to the federal government; (3) reactivates and amends 1991-95 authority to require USDA to administer sugar marketing allotments limiting the amount of raw cane mills and beet refiners can sell, in order to prevent loan forfeitures; (4) allows USDA to transfer sugar in CCC inventory to cane and beet processors (in conjunction with producers who agree to reduce production of these crops); (5) requires USDA to extend loans for "in-process sugars and syrups" derived from cane and beets that are not now eligible for price support; (6) requires the CCC to establish a storage loan facility program to provide financing for the construction or upgrade of facilities to store and handle raw and refined sugar; (7) reduces the interest rate charged on price support loans by 100 basis points (1%); and (8) repeals the sugar marketing assessment fee starting in FY2002. The Committee did not accept the sugar production sector's requests to slightly increase support levels as part of its overall farm bill strategy, and to eliminate the loan forfeiture penalty.

The ASA commended the Committee for reinstating a U.S. sugar policy that "will ensure stable prices for farmers and consumers and operate at no cost to taxpayers." It views the "domestic inventory management tool" included in H.R. 2646 as "restoring balance to the U.S. sugar market" when there is a surplus. Its spokesman acknowledged that the industry "is reluctant to face the prospect of limited marketings in some years," but that trade commitments under the WTO and NAFTA agreements require the United States to import as much as 1.5 million ST of sugar each year (about 15% of consumption), "whether we need that sugar or not." He added that growers and processors under marketing allotments will have the flexibility to plant as much crops and produce as much sugar, respectively, as they wish, but noted that processors who increase sugar output faster than the growth in U.S. demand "may have to postpone the sale of some sugar, and store that sugar at their expense until the market requires it."

Two Members of Congress opposed to the sugar program expressed disappointment that the House Agriculture Committee "decided to ignore the failure of the U.S. sugar program," noting that the measure approved contains "no meaningful reform" and turns "the clock back on consumers, workers, taxpayers and the environment."

If enacted into law, this proposal would guarantee price protection to farmers and sugar crop processors at currently-set levels (18 cents/lb. for raw cane, 22.9 cents/lb for refined beet). The Secretary of Agriculture would have discretionary authority to implement payment-in-kind programs that in time could result in the complete transfer of the sugar remaining in CCC inventory to processors, and remove its potential to dampen prices. The requirement to implement marketing controls on sugar may "lock" the domestic sugar production sector into a declining share of the U.S. market, as some have observed. These controls have the potential for significantly reducing the amount of sugar that U.S. processors can market starting as soon as FY2004, particularly if USDA intends to meet the program's no cost objective. Such a scenario could be mitigated to some degree if U.S.-Mexican trade negotiators reach an accommodation that slows down the pace of sugar allowed to enter the U.S. market.

Program Phase-Out Proposal

The "Sugar Program Reform Act" (H.R. 2081), introduced by Representative Dan Miller on June 6, 2001, is largely identical to his proposal introduced in the 106th Congress (H.R. 1850). This bill proposes to: (1) lower sugar price support levels in stages through 2004; (2) require USDA to make only recourse loans to sugar processors; (3) terminate processor access to recourse loans, and not allow USDA to use any funds to make payments or purchases to support sugar, after the 2004 crops; and (4) require the President to use all available authorities to enable USDA (starting in FY2002) to supply the domestic market with raw cane sugar at prices not greater than the higher of: the world sugar price (adjusted for delivery to the U.S. market), *or* the raw cane sugar loan rate in effect, plus interest. The recourse loan rate for raw cane sugar would decline 1 cent per pound each crop year (i.e., to equal 17 cents/lb. in the 2001/02 marketing year, 16 cents/lb. in 2002/03, 15 cents/lb. in 2003/04, and 14 cents/lb. in 2004/05). Loan rates for refined beet sugar would decline in tandem with the reduction in the raw cane sugar loan rate. After the processing of the 2004 sugar crops is completed, decisions made by the Executive Branch in exercising its authority to administer the sugar import quotas would effectively determine U.S. sugar policy and the level of domestic sugar prices.

The Coalition for Sugar Reform (an association of food manufacturers, consumer and taxpayer advocacy groups, environmental organizations, and publicly-traded cane refiners) has endorsed the Miller bill. The Coalition has long claimed that the current sugar program "is an economic disaster for producers, consumers, workers in urban centers who are losing their jobs and the food manufacturing industry" and should be reformed. Its spokesman stated that H.R. 2081 would do this by: (1) securing adequate supplies for consumers, industrial users, and cane refiners, (2) accommodating present and future U.S. international trade obligations by providing market access for imports, (3) removing "the current economic incentives for overproduction, and (4) allowing sugar to trade at market prices "below support levels when market forces dictate."

If enacted into law, this proposal would reduce the level of price support by 22% from current levels. Allowing USDA to make only recourse loans removes processors' access to price protection, and thus transfers to them the entire risk of taking out loans. This approach starts shifting responsibility for sugar policy from Congress to the Executive Branch, by granting the President authority to administer the import quota, who will have complete flexibility to do so starting in 2005. By mid-decade, sugar crop production and processing in the higher cost producing areas can be expected to decline, as some analyses indicate. This in turn would allow that portion of U.S. sugar needs to be met from increased imports.

LEGISLATION

S. 753 (Breaux)
Amend the Harmonized Tariff Schedule of the United States to prevent circumvention of the sugar tariff-rate quotas. Introduced April 6, 2001; referred to Committee on Finance.

H.R. 2081 (Miller, Dan)
Sugar Program Reform Act. Amends the Agricultural Market Transition Act of 1996 to change the type of price support available for sugarcane and sugar beets from a nonrecourse loan program to a solely recourse loan program, to gradually reduce the level of price support available for sugarcane and sugar beets, and to eliminate the program after the 2004 crops of sugarcane and sugar beets. Introduced June 6, 2001; referred to Committee on Agriculture.

H.R. 2646 (Combest)
Agricultural Act of 2001. Title I, Subtitle C, Chapter 2 amends the Agricultural Market Transition Act of 1996 to authorize a non-recourse loan program for sugar crops through 2011 at current loan rate levels, reinstate the requirement that the sugar program be administered at no-net cost to taxpayers, eliminate the marketing assessment on domestically-produced sugar, authorize the USDA to transfer sugar in CCC inventory to farmers who agree to reduce production (i.e., payment-in-kind program), authorize loans for sugar storage facilities, and reduce the CCC interest rate on sugar price support loans (Sections 151 and 153). Section 152 amends the Agricultural Adjustment Act of 1938 to authorize the Secretary of Agriculture to establish marketing allotments for domestically-produced sugar to eliminate loan forfeitures when certain conditions exist. Amended and passed by voice vote by the Agriculture Committee on July 27, 2001. H.Rept. 107-191, Part 1, filed August 2.

FOR ADDITIONAL READING

Congressional Research Service, Sugar Program entry in the CRS Electronic Agriculture Policy and Farm Bill Briefing Book.

USDA. Economic Research Service. Sugar and Sweetener Briefing Room. Available on the Web at [http://www.ers.usda.gov/briefing/sugar/]