Order Code IB95117

CRS Issue Brief for Congress

Received through the CRS Web

Sugar Policy Issues

Updated August 29, 2003

Remy Jurenas
Resources, Science, and Industry Division

CONTENTS

Sugar Policy Issues

SUMMARY

The sugar program is designed to protect incomes of growers of sugarcane and sugar beets, and of firms that process each crop into sugar. To accomplish this, the U.S. Department of Agriculture (USDA) supports domestic sugar prices by making available loans at minimum price levels to processors, restricting imports , and limiting the amount of sugar that processors can sell domestically — intended to meet U.S. import commitments under two trade agreements.

Debate in 2001-02 on future U.S. sugar policy occurred against the backdrop of a sugar oversupply situation, which resulted in historically low prices and processors' subsequent forfeiture of sugar pledged as collateral for price support loans to USDA. Sugar crop growers and processors stressed the industry's importance in providing jobs and income in rural areas. Sugar users, some cane refiners, and their allies argued U.S. sugar policy costs consumers and results in lost jobs at food firms in urban areas. The sugar production sector called for resolving trade disputes, retaining current loan rate levels, and relying on domestic marketing controls to control supplies. Program opponents advocated various approaches to reduce the level of price support, and/or phase out the program. Three amendments offered by opponents were rejected during floor debate.

The sugar program enacted as part of the 2002 farm bill increases the effective support level by 5-6%, gives USDA tools to operate the program at no cost, and reactivates "marketing allotments" to limit the amount of domestically produced sugar processors can sell in the U.S. market.

A provision in the Trade Act of 2002 requires USDA and U.S. Customs to monitor imports of sugar and sugar-containing products to ensure their entry does not circumvent the import quota and undermine the sugar program. In their last report to Congress, USDA reported sweetened cocoa powder from Mexico had entered to circumvent the import quota, and listed steps taken to stop it.

Sugar producers and users continue to scrutinize USDA decisions on the new program's authorities. The level at which USDA sets the national sugar allotment quantity has dominated the discussion, because of its impact on sugar prices. Some producers have expressed concern when this level is set "high" (FY2004). Users complained when the allotment was set low (early FY2003).

Efforts by U.S.-Mexican negotiators to resolve two longstanding sweetener trade disputes — the level of access for Mexican sugar in the U.S. market, and for sales of U.S. high fructose corn syrup (HFCS) to Mexico — have stalled. Though both sides apparently reached agreement in late 2002 on some points, differences remain on the length of any prospective agreement, how to handle over-quota Mexican sugar exports, and the status of Mexico's tax on HFCS-sweetened soft drinks.

The U.S. sugar production sector argues liberalizing trade in sugar should be addressed in multilateral WTO negotiations, but excluded from hemispheric and bilateral free trade agreements (FTAs). Its fear is market access provided by FTA candidates, also major sugar exporters, would undermine the sugar program and threaten the sector's viability. Sugar users advocate including sugar in all trade negotiations, eyeing the prospect of lower-priced sugar they have not been able to secure through congressional initiatives.

Most Recent Developments

The U.S. Department of Agriculture (USDA) on August 13, 2003, announced (1) the overall allotment quantity and resulting allocations for 2003 crop beet sugar and raw cane sugar (under the sugar marketing allotment provisions authorized by the 2002 farm bill), and (2) the tariff-rate quotas for raw, refined, and specialty sugar imports. At a public hearing held August 27, a spokesman for some sugar cane growers and processors expressed concern that USDA had set the allotment quantity too high, with potential adverse consequences for the domestic sugar production sector and the effectiveness of U.S. sugar policy.

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 supplied roughly 55% of the U.S. sugar market. This share grew over the last 15 years, reflecting the price protection provided by a sugar program. In FY2002, domestic production filled 89% of U.S. sugar demand for food and beverage use. As high-fructose corn syrup (HFCS) 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. The import share of the U.S. sugar market last year was 11%.

U.S. sugar policy maintains domestic sugar prices considerably above the world market price, and is structured primarily to protect the domestic sugar producing sector (sugar beet and sugarcane producers, and the processors of their crops) and to ensure a sufficient supply. As a result of the price differential, U.S. consumers and food product manufacturers pay more for sugar and manufactured food products where sugar is an ingredient than they would if imports entered without any restriction.

The sugar program differs from most of the other commodity programs in that USDA makes no direct payments to growers and processors. Structured this way, taxpayers do not directly support the program through government expenditures. This fact is highlighted as a positive feature by the sugar production sector and its supporters. The program's support level and import protection, though, keep the U.S. sugar price above the price of sugar traded internationally, and constitute an indirect subsidy to the production sector by way of higher costs paid by U.S. sugar users and consumers. Program opponents frequently refer to this subsidy component to argue for changes to U.S. sugar policy.

Main Features of U.S. Sugar Policy

To support U.S. sugar prices, the USDA extends short-term loans to processors at statutorily-set price levels 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. sugar 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, and under the 2002-authorized program (see "Sugar Program in the 2002 Farm Bill" for details), on how it will administer sugar marketing allotments and other authorities, affects market prices. USDA administers these policy instruments to ensure that growers and processors realize the benefits of price support the law provides, whether or not loans are actually 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 (a requirement changed slightly by the 2002 farm bill) 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. USDA loans at times are attractive to sugar processors as a source of short-term credit at below-prime interest rates.

Loan Rates. The 2002 farm bill freezes loan rates — 18¢ per pound for raw cane sugar and 22.9¢ per lb. for refined beet sugar — at levels first set in 1995 for another 6 years (through the 2007 crop year). The 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 terms of end use. Any beet or cane processor that meets statutory requirements can take out a non-recourse loan at these rates (adjusted by region and other factors). The loan's "non-recourse" feature means a processor can exercise the legal right to hand over sugar it initially offered USDA as collateral to fully repay the loan, if the market price is below the support level when the loan comes due.

Effective Support Levels. The above loan rates, though, do not serve as the price floor for each type of sugar. In practice, under the 2002 farm bill, USDA's aim is to support the raw cane sugar price (depending upon the region) at not less than 20.1¢ to 21.2¢ per 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 *plus* location discounts). Similarly, USDA seeks to support the refined beet sugar price at not less than 23.0¢ to 25.9¢ per lb. (i.e., the regional loan rate *plus* specified marketing costs *plus* the interest paid on a price support loan), depending on the region. USDA has available various authorities to ensure that market prices do not fall below these "loan forfeiture," or higher "effective" price support, levels. These include (1) limiting the amount of foreign raw sugar imports allowed into the United States for human consumption, (2) limiting the amount of domestically-produced sugar permitted to be sold under the new marketing allotment mechanism, and (3) offering sugar in its inventory to processors (and growers) who agree to reduce production. A loan forfeiture (turning over sugar pledged as loan collateral to USDA) occurs if a processor concludes, also weighing other factors, that the domestic market price at the end of the loan term is lower than the "effective" sugar price support level. These support levels essentially provide a processor with a price guarantee.

Import Quotas

USDA restricts the quantity of foreign sugar allowed to enter the United States for refining and sale for domestic food and beverage consumption. By controlling the amount of sugar allowed to enter, USDA seeks to ensure that market prices do not fall below effective price support levels and that it does not acquire sugar due to any loan forfeitures.

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. Although 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 and a formula 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 specialty) sugar.

The Office of the U.S. Trade Representative (USTR) is responsible for allocating these TRQs among 41 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 the WTO quota is subject to a prohibitive tariff, which serves to protect the U.S. sugar-producing sector from the entry of additional foreign sugar. The tariff on above-quota sugar entering from Mexico under NAFTA continues to decline, and is viewed as a growing threat by the domestic production sector. In addition, other TRQs limit the import of three categories of sugar-containing products (SCPs — products containing more than 10% sugar, other articles containing more than 65% sugar, and blended syrups). Quota and tariff provisions differ depending on whether these imports enter from Mexico, from Canada, or from any other country.

USDA on August 13, 2003, set the FY2004 tariff-rate quotas for sugar imports (raw and refined) at 1.274 million short tons (ST), raw value. This amount is slightly higher than the U.S. commitment made under WTO rules, and also slightly above the TRQs' total quantity announced for FY2003. At present, it does not appear likely that USTR will announce a sugar quota under the terms of NAFTA's sugar side letter (see "Sugar Trade Issues — Sweetener Disputes with Mexico").

Sugar Market and Program Developments

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

Congressional debate over sugar policy leading up to the 2002 farm bill changes took place against the backdrop of structural changes in the industry, historically low domestic sugar prices caused by oversupply, and the inability of policymakers working within the 1996-enacted U.S. sugar program 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 more foreign sugar to enter the U.S. market (under the import quota).

In marketing year **1999/2000**, record domestic sugar production from the 1999 crops, combined with imports of sugar permitted under trade agreements or entering not subject to any limitation, contributed to a substantial oversupply. Since the U.S. government could not further reduce imports to accommodate higher domestic sugar output without breaking its market access commitment to other countries made under WTO rules, USDA intervened to bolster market prices that had fallen below effective price support levels. Government sugar purchases, and USDA's decision to pay growers sugar "in-kind" to plow under some of their to-be-harvested crop in order to reduce output, though, did not raise prices enough to enable processors to pay back all of their price support loans when they came due. Some processors exercised their right to "forfeit" 10% of FY2000 sugar output (1.1 million ST), and USDA recorded significant program outlays ($465 million in FY2000).

During **2000/2001**, USDA reduced about one-third of its inventory under the first sugar payment-in-kind (PIK) program. Lower raw cane sugar output helped prices to recover above loan forfeiture levels. Refined beet prices, though, did not rise above their forfeiture levels until late in September 2001, largely due to a reduced production outlook, and

USDA's policy to continue disposing of its sugar inventory in order to reduce storage costs and bolster market prices. It announced sales would occur whenever specified market price levels thresholds were reached, and that it would offer another PIK program.

In **2001/2002**, USDA further reduced its inventory by completing a second sugar PIK program, conducting several sales of refined beet sugar (generating $130 million in receipts), and facilitating the exchange of some of its acquired raw cane sugar for what some foreign countries would have shipped to the U.S. market under their respective allocations of the U.S. sugar TRQ. These initiatives, weather-related concerns about the beet crop outlook in the Red River Valley area, and knowing that marketing allotments would limit sugar sales after October 1, 2002, contributed to a firming in raw cane and refined beet sugar prices. With year-ending prices near or above loan forfeiture levels, processors did not forfeit on any loans taken out earlier.

In the current **2002/2003** marketing year, sugar prices initially strengthened considerably, reflecting the introduction of statutory marketing allotments that limited sales of domestic sugar. Prices continue to remain well above loan forfeiture levels (see "New Sugar Program's Provisions"), even though USDA has twice increased the overall allotment quantity (now 12.5% above the initially announced level) to effectively allow all of 2002 crop processed sugar to be marketed without the allotment restriction, and has also sold the sugar remaining in its inventory (generating $117 million in receipts).

Sugar Program in the 2002 Farm Bill

The new sugar program (authorized by Sections 1401-1403 of P.L. 107-171) slightly increases effective price support levels for raw cane sugar and refined beet sugar, and reactivates a mechanism (called "marketing allotments") to limit the amount of domestically produced sugar that can be sold when imports are projected to be below a specified level. Other provisions require USDA to operate the program again at no-cost to the federal government, modify some features of the 1996-2001 program, explicitly authorize a payment-in-kind program for sugar, and prescribe in great detail how USDA must administer marketing allotments. Certain provisions are intended to meet the sugar production sector's objective that the program operate at no cost to the government.

During floor debate in each chamber, program opponents failed in efforts to reduce the level of price support, and/or to phase out the current program. The Bush Administration did not present any proposals with respect to the sugar program, but earlier questioned the practice of compensating growers for not harvesting a portion of their crop. Conferees easily resolved the few differences between the House and Senate sugar program provisions. The most important was an agreement to repeal the 1996-enacted approximate one-cent penalty imposed on a processor that decides to forfeit any price support loan taken out (i.e., hand over sugar to the government as payment).

New Sugar Program's Provisions. The new program is designed to maintain a balance between supply and demand in the U.S. sugar market, ensure that sugar producers and processors receive enhanced price support and other program benefits that offset some of the revenue lost to reduced sales under the new allotment mechanism, and remove most of the federal government's budgetary exposure. The program reflects the sugar production sector's willingness to accept reduced sales in return for gaining price protection for the quantity of sugar that the marketing allotment mechanism allows processors to sell. The sector's objective, expecting little growth in domestic sugar demand and accepting U.S. trade commitments that allow other countries access for a minimum quantity of their sugar, is to maintain the status quo for as long as possible, until U.S. market demand for sugar increases and/or trade negotiations conclude in a way that favors their interests.

Major provisions (with some discussion on a few) —

- **reauthorize** the sugar program ***for 6 years*** (i.e., 2002 to 2007 crop years).

- **increase the effective price support level by 5-6%** (to a range of 20¢-22¢ per pound for raw cane sugar, and 24¢-27¢ per lb. for refined beet sugar). Though the loan rates continue at the 1996-enacted levels (18¢ per lb. for raw cane sugar, and 22.9¢ per lb. for refined beet sugar), the repeal of the loan forfeiture penalty effectively raises by about one cent the minimum price levels USDA uses to administer the no-cost objective.

- **make non-recourse loans available to processors of sugarcane and sugar beets** at the specified loan rates. The loan program is expanded to allow loans to be made also for in-process sugars and syrups at 80% of the raw cane or refined beet loan rate.

- **repealed the loan forfeiture penalty** effective May 13, 2002.

- **repealed the sugar marketing assessment** retroactively to October 1, 2001. This will save the sugar production sector about $40 million annually.

- **require USDA to operate the sugar program at no cost** to the federal government using two tools — **marketing allotments** and **sugar payment-in-kind** (see below for explanations). USDA is directed to use both tools to ensure no loan forfeitures occur. In other words, administrative decisions must be made so that domestic sugar prices do not fall below effective price support levels that would make it more attractive for processors to hand over to USDA sugar pledged as collateral for a price support loan.

- **require marketing allotments when imports are below 1.531 million short tons (ST)**. By limiting the amount of domestically-produced sugar that raw cane mills and beet refiners can sell, this mechanism ensures that the United States meets its annual market access commitments for sugar imports under the WTO agreement (1,255,747 ST) and under NAFTA's sugar side letter in effect through FY2007 (up to a maximum 275,578 ST). Provisions detail the formula that USDA must follow to calculate the amount of domestic sugar that can be sold (i.e., the "overall allotment quantity," or OAQ), specify the factors to apply in making this determination, and split the allotment between the beet and cane sectors at 54.35% and 45.65%, respectively. Additional rules specify how the raw cane allotment is to be distributed among sugarcane producing states, and then among the mills in each state. Separate rules stipulate how the beet sugar allotment is to be allocated among processing companies (many of which operate across state lines). Once the detailed calculations are made, each firm will be able to sell only as much sugar as stated in its allotment notification received from USDA.

(USDA's May 2003 upward adjustment in the 2002/03 marketing year's OAQ to almost 8.7 million ST effectively allows all projected beet sugar and raw cane sugar production to be sold. In other words, the restrictive effect of allotments no longer applies for the balance of FY2003. USDA's OAQ announcement for FY2004, though, will limit some sales — much more for raw cane sugar than for refined beet sugar (**Table 1**).)

Table 1. Comparison of Marketing Allotments to Projected Sugar Production, 2003/2004

	Statutory Share	Announced Allotments	Projected Production	Estimated Reduction in Sales	Reduction as Share of Production
	percent	*1,000 short tons, raw value*			*percent*
Refined Beet	54.35	4,647	4,659	12	0.3
Raw Cane	45.65	3,903	4,226	323	7.6
Total	100.00	8,550	8,885	335	3.8

Note: Allotments reflect USDA's August 13, 2003 announcement. Projected sugar production reflects USDA's August 2003 supply estimate. Sugar sales reductions by sector are derived as the difference between production and allotments, and could change during the year as USDA revises production estimates and recalculates the factors used to derive the OAQ.

- explicitly **authorize a sugar payment-in-kind (PIK) mechanism** that allows sugar processors (acting in concert with producers of cane and beets) to submit bids to obtain sugar in USDA's inventory in exchange for reducing production. This provision supplements 1985 farm bill authority that USDA tapped to implement the 2000 and 2001 sugar PIK programs.

- **authorize a new storage loan facility program** to provide financing to processors for constructing or upgrading facilities to store and handle raw cane and refined beet sugar. This will give qualifying processors access to below-commercial rate financing to install additional facilities for holding sugar that cannot be sold when marketing restrictions mandated by allotments are in effect.

- **reduce the interest rate USDA charges on price support loans** extended to sugar processors by 100 basis points (1%). This provision is unique to the new sugar program; loans made available to producers of eligible crops will continue to carry an interest rate equal to what USDA's Commodity Credit Corporation (CCC) pays the U.S. Treasury for its funds plus 100 basis points.

(Final regulations reflect USDA's decision to apply the same interest rate on sugar non-recourse loans as it applies to loans extended to other commodities (2.0% for loans made in July 2003). The sugar production sector views this as contrary to the enacted provision; USDA's stance is the farm bill did not establish a specific sugar loan interest rate. S.Res. 127 expresses the sense of the Senate that USDA should reduce the interest rate by 1% to conform to the 2002 farm bill provision.)

Program Implementation. To implement the new sugar program for the 2002 and subsequent year sugar crops, USDA issued revised regulations (published in the August 26, 2002 *Federal Register*) to reflect farm bill changes. Administrative announcements on the **FY2003** program provided details on: the breakdown of 2002/03 marketing allotments between cane and beet (issued August 27, 2002), regional loan rates (September 27), the allocations of these allotments among five cane producing states, all cane processors, and all beet refiners (October 1), revisions to company-specific beet sugar allocations to reflect recent mergers (November 18), the increase in the overall allotment quantity (OAQ) to reflect lower domestic sugar output in FY2003 and the lack of an agreement with Mexico on the level of access for its sugar in the U.S. market (January 10, 2003), the sales of the balance of the sugar inventory held by USDA (January 10), revisions to allocations of the OAQ among five cane producing states, all cane processors, and all beet refiners (January 15), reassignments of unused cane sugar allocations from processors in Hawaii and Puerto Rico to processors in Florida, Louisiana, and Texas (March 13), the distribution of Talisman's sugar marketing allocation among the Florida sugarcane processors (March 21), another increase in the OAQ to allow "blocked" sugar stocks to be marketed as prices remained well above loan forfeiture levels (May 13), further revisions to allotments of the increased OAQ among the five cane states and cane processors (May 19), and additional reassignments of unused cane sugar allocations from processors in Louisiana to those in Florida and Texas, and of unused beet sugar allocations to other beet refiners (May 19). USDA's second increase in the 2002/03 marketing year's OAQ (in May) to almost 8.7 million ST effectively allows all FY2003 beet sugar and raw cane sugar production to be sold. For the **FY2004** program, USDA on August 13, 2003, announced the OAQ and breakdown of 2003/04 marketing allotments between cane and beet sugar.

Also, USDA on June 5, 2003 determined that the Arizona Sugar Factory can receive up to a 50,000 ton raw cane sugar allotment in FY2004, subject to meeting specified conditions. USDA on July 17 affirmed earlier decisions to deny requests from the Pacific Northwest Sugar Company for an increase in its beet sugar marketing allocation and from Cargill for a beet sugar marketing allocation.[1]

USDA's determinations and subsequent adjustments of the OAQ have been the most significant decisions made in program implementation. At a public hearing held September 4, 2002 on the initial OAQ announcement for **FY2003**, the sugar production sector commented favorably on USDA's decision to set the allotment quantity at the then-announced level. Sugar users (primarily food manufacturing firms) disagreed, stating USDA set the allotments much lower than called for, when viewed against historical ending stock indicators. Users were pleased with USDA's January 10, 2003 decision to increase the allotment quantity, viewing it as more in line with the way the sugar program has been administered in the past. At a meeting held on March 12, industrial sugar users and one cane refiner asked USDA to increase the OAQ by up to 300,000 short tons to offset the amount the beet sector does not have to sell this season due to lower production. Sugar growers and

[1] [http://www.fsa.usda.gov/ao/epas/dsa/hot_topics.htm] (as accessed August 26, 2003)

processors opposed such action, recommending that USDA act cautiously so as not to flood the market. At the August 27, 2003, hearing held to receive comments on USDA's initial OAQ announcement for **FY2004**, a spokesman for the Florida, Texas and Hawaii sugar cane sectors stated that USDA had set the allotment quantity too high, and argued that it "will provide overly generous benefits to sugar users at the expense of farmers." He further expressed concerns about the effects this action will have on the domestic sugar price, the profitability of producers and processors, and the effectiveness of U.S. sugar policy.

Background and Debate on New Program. The 2002 farm bill's sugar provisions reflect the recommendations offered by the American Sugar Alliance (ASA) — representing sugar farmers and processors — in testimony presented to the House and Senate Agriculture Committees in the spring and early summer of 2001. The ASA further commended the subsequent committee and floor actions taken that reinstated 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 the farm bill as "restoring balance to the U.S. sugar market" when there is a surplus. Its spokesmen have 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." They 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."

House Debate. The nearly identical sugar programs reported by the House and Senate Agriculture Committees were challenged by program opponents during floor debate. In the House, Representatives Dan Miller and George Miller offered an amendment on October 4, 2001, to replace the Committee's proposed sugar program with an approach they argued would result in a sugar policy more oriented to market forces. They had earlier expressed disappointment that the 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." Their amendment proposed to retain the current program's non-recourse loan feature, reduce the current level of sugar price support by almost 6%, increase financial penalties on processors that hand over sugar to the CCC rather than repay any non-recourse loans taken out, and designate $300 million from the amendment's savings for conservation and stewardship programs (with a priority for efforts in the Everglades). Price support would be reduced by 1¢ per pound for raw cane sugar, and 1.2¢ per pound for refined beet sugar (to 17¢ / lb. and 21.6¢ / lb., respectively). Penalties that processors would pay to the CCC would double if they forfeit on their price support loans (increasing to 2¢ / lb. for raw cane sugar, and 2.14¢ for refined beet sugar). The House rejected this amendment on a 177 to 239 vote.

The Coalition for Sugar Reform (an association of food manufacturers, consumer and taxpayer advocacy groups, environmental organizations, and publicly-traded cane refiners) favored this amendment offered during House debate. 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 spokesmen have testified "reform" 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."

Senate Amendments. Two amendments offered during floor debate proposed more sweeping changes to the sugar program. Both mandated recourse (i.e., removing processors' access to price protection) rather than non-recourse loans and the program's phase out by mid decade. Senator Lugar's amendment, offered on December 12, 2001, would have completely phased out the sugar and other commodity programs after the 2005 crops. Until then, USDA could only make recourse loans to sugar processors. The level of price support would have been "progressively and uniformly" lowered starting with the 2003 crops in order to reach zero in 2006. Price support would have been replaced with vouchers of up to $30,000 made available annually through 2006 to any sugar producer who signed a "risk management contract," and undertook specified risk management activities such as buying whole farm revenue insurance and/or contributing to a whole farm stabilization account. This voucher system would have applied to all (and not just sugar crop) producers. His proposal was defeated on a 70-30 vote. Senator Gregg's amendment (offered December 12) similarly proposed a recourse loan program to be phased out by 2006, but differed in requiring that the budget savings be used to increase benefits for the food stamp program's shelter expense deduction. His proposal was tabled 71-29 during floor debate. Similar proposals were introduced as identical bills (H.R. 2081 and S. 1652) earlier in the session.

Sugar Trade Issues

The United States must import sugar to cover the balance of its domestic needs that the domestic sugar production sector cannot supply — currently about 12%. Accordingly, provisions found in trade agreements approved by the United States that apply to both imports and exports of sugar, sugar-containing products, and other sweeteners such as corn syrup affect the economic interests of the U.S. sugar production sector, domestic cane refiners, U.S. corn producers, U.S. corn sweetener manufacturers, U.S. sugar users, and sugar exporting countries.

Trade in sweeteners affects 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 were not subject to import restrictions until recently, have added, or could under certain conditions, contribute to a U.S. sugar surplus and pressure prices downward. At present, efforts to resolve U.S.-Mexican sweetener disputes are the most important sugar trade issue. The success or failure of continuing negotiations will be a key factor affecting USDA's implementation of the new sugar program's provisions. Economic 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's terms; (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 until recently because of concern that its domestic sugar sales would increasingly be displaced by the Mexican soft drink industry's import of cheaper HFCS from U.S. corn sweetener firms.

The importance of this matter is reflected in the fact that sweetener issues have been frequently discussed at meetings held by both countries' presidents since the late 1990s. Though substantive negotiations between the U.S. and Mexican governments resumed in 2002, prospects that an agreement will soon be reached have faded.

A provision in the trade promotion authority and adjustment assistance measure (Section 5203 of P.L. 107-210) addresses in part the domestic sugar industry's concern that some sugar-containing products are entering the U.S. market in a deliberate effort to circumvent the U.S. sugar import quota system. Separately, the sugar production sector advocates that the Bush Administration address further liberalization in sugar trade in the comprehensive multilateral WTO negotiations rather than in hemispheric and bilateral free trade negotiations involving major sugar exporting countries. Sugar users, though, argue that sugar should not be excluded from any prospective regional or bilateral trade agreement.

Sweetener Disputes with Mexico

Mexico's Tax and Trade Policies on Corn Syrup Imports from the United States. Legislation passed by the Mexican Congress on January 1, 2002, to impose a 20% tax on soft drinks containing corn syrup but not sugar temporarily eliminated the market for U.S. corn and HFCS (processed from corn) in Mexico and jeopardized the viability of two U.S. companies that manufacture HFCS there. The U.S. corn and HFCS sectors viewed this as a step back in negotiating a resolution to a long-standing HFCS dispute and have since pressed Bush Administration officials to persuade Mexican authorities to remove this tax. Observers view the soft drinks tax as an effort by the Mexican sugar industry to capture back their home market and apply pressure on the United States to negotiate a comprehensive solution on all sweetener disputes sooner rather than later. Though Mexican President Fox in late March 2002 suspended the application of this tax through the end of September, the Mexican Congress on April 2, 2002, voted to challenge his decision in the country's Supreme Court. Reflecting this uncertainty, U.S. exports to Mexico of corn for processing into sweeteners and also of HFCS fell noticeably, and continue to remain at low levels.

The imposition of this tax is related to earlier WTO and NAFTA panel rulings that found Mexico's 1998 decision to impose anti-dumping duties on imports of U.S.-produced HFCS to prevent further damage to its domestic sugar sector was inconsistent with its trade commitments. To comply with them, Mexico on April 22, 2002, established a new tariff rate quota for HFCS imports from the United States. Imports above the 148,000 metric tons (MT) quota will be subject to a 210% duty. Observers note that this quota equals the amount of Mexican sugar the U.S. government allowed to enter in FY2002 under NAFTA (see below) and WTO provisions. In subsequent action, Mexico completely lifted its high anti-dumping duties on imports of U.S. HFCS in mid May 2002. Mexico's Supreme Court on July 12, 2002, ruled in favor of Congress' challenge and reinstated the 20% tax on soft drinks manufactured with HFCS. Mexico's Finance Ministry, in submitting its 2003 budget to Congress on November 5, proposed only to slightly alter the tax rather than eliminate it altogether as sought by the United States. In mid-December, the Mexican Congress decided to retain this tax in approving the 2003 budget, clouding prospects for a sweetener deal. In light of these developments, one U.S. firm exporting HFCS to Mexico, and also operating HFCS manufacturing plants there (Corn Products International), announced on January 28, 2003, its intent to seek $250 million in compensation from Mexico under NAFTA's investment provisions. The company stated that the Mexican government has violated "obligations with respect to foreign investors under the NAFTA, including those regarding non-discriminatory treatment and expropriation." It specified the compensation amount represents lost profits for past and future years ($35 to $40 million in lost annual income) and other costs related to its operations in Mexico.

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. Until summer 2002, U.S. and Mexican negotiators disagreed, however, over just how much sugar Mexico actually could export to the United States. Their disagreement centered on which version of the NAFTA agreement governed this issue. U.S. negotiators based their position on the sugar side letter (dated November 3, 1993) to the NAFTA agreement agreed to in last minute talks between U.S. Trade Representative and his Mexican counterpart. The side letter was included along with other NAFTA documents that President Clinton submitted to Congress together with the implementing legislation. Mexican negotiators instead based their position on the sugar provisions found in the August 1992 NAFTA agreement and signed by each country's president in December 1992.

The side letter effectively placed 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. Using FY2002 to illustrate, Mexico under the side letter's terms can export its "net surplus" but not more than 250,000 MT of sugar duty free. USDA announced on September 18, 2001, that Mexico under the side letter's formula can sell 137,788 MT of sugar to the United States in FY2002. 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, Mexican officials argued that 550,000 MT would have been eligible for entry. Reflecting the lack of agreement in efforts to resolve these differences and Mexico's inability to show a sugar "surplus," the U.S. Government did not announce a NAFTA sugar quota in FY2003 and FY2004.

The U.S. sugar production sector has been concerned that a decision not to abide by the side letter would result in a flood of additional Mexican sugar into an already well-supplied U.S. market. U.S. cane refiners have held firm to their position that Mexican shipments 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 forward, the U.S. sugar industry is most apprehensive about the impact of other NAFTA provisions scheduled to take effect. These include substantial over-quota sugar imports from Mexico projected to occur starting in FY2004 (e.g., likely to be price competitive in the U.S. market should world sugar prices fall to historically low levels), and unlimited duty-free imports beginning in FY2008.

Status of Negotiations. Statements made by U.S. and Mexican negotiators suggest they have laid aside the issue of whether or not NAFTA's sugar side letter applies, in favor of pursuing negotiations to arrive at a comprehensive sweetener agreement acceptable to both sides and their respective domestic interests. On July 15, 2002, USTR presented a proposal to the Mexican Government that effectively would double the level of FY2002 access for Mexican sugar to the U.S. market if Mexico reciprocates to allow imports of an equal amount of U.S-produced HFCS. The U.S. proposal contained a number of other features to address other issues of concern to both the U.S. corn refiner and sugar sectors. The Mexican government responded in late August, and again in late September, with its counterproposals. The status of key negotiating positions to date reportedly is as follows. On duty-free access to the U.S. market for its sugar, Mexico proposes a 300,000 MT quota (compared to the initial U.S. offer of 275,000 MT). Both sides have agreed that Mexico would receive additional access equal to 25% of any growth in the U.S. sugar market over the agreement period. On U.S. HFCS exports to Mexico, each side proposes a duty-free quota equal to the U.S. sugar quota level. However, the U.S. is seeking some additional allowance to offset the loss of 2002 HFCS exports to Mexico. Reacting to the U.S. proviso (intended to protect U.S. cane refiners) that Mexican sugar shipments be split 80% raw / 20% refined, Mexico proposes to condition HFCS imports to a 50/50 split between its soft drink and bakeries industries. U.S. corn refiners oppose this, viewing such a split as restricting market access since almost all HFCS export sales are to the soft drink sector. Mexico would repeal its 20% tax on HFCS-sweetened soft drinks as part of a deal.

Differences, though, remain on two key issues — the duration of an agreement, and treatment of over-quota sugar imports from Mexico. First, the United States reportedly is seeking a "permanent agreement" to allow for some restraint on sugar imports after 2008, a position sought by the U.S. sugar sector. Mexico wants an "interim" agreement that would expire no later than 2008 to reflect NAFTA's original timetable for complete liberalization in sugar trade. Second, U.S. negotiators want Mexico to commit to ship not more than its quota amount (e.g., not take advantage of NAFTA's declining tariffs on over-quota imports to ship additional amounts). Mexico has signaled it may accept this, depending on how the U.S. side proposes to implement such a commitment. The United States also has reportedly proposed a peace clause against taking any anti-dumping action against over-quota sugar imports, in exchange for Mexico giving up its NAFTA rights after 2008.

Adding pressure to the negotiations were: (1) calls by Mexican farmers and legislators that its government hold off complying with NAFTA provisions that eliminate quotas and tariffs on U.S. imports of potatoes, pork, poultry, among other products, effective January 1, 2003, and (2) the prospect that if the United States applied the side letter's provisions in FY2003, Mexican access to the U.S. sugar market would be much smaller than FY2002's 148,000 MT. With the Mexican Congress' deciding to retain the tax on HFCS-sweetened soft drinks in the Government's 2003 budget and then adjourning, the prospect that an overall deal can soon be reached faded. However, top Mexican Government leaders, including President Fox, have stated they will not bend to pressure to renegotiate NAFTA's agricultural provisions but pledge to protect the country's farmers. With signs also that the Mexican sugar sector can live with the status quo (not having a surplus to export), combined with U.S. corn producers' and corn refiners' concerns about the growing economic fallout of no agreement, U.S. lawmakers on December 16, 2002, called on the Bush Administration to work toward an immediate conclusion to the negotiations. On March 14, 2003, 31 House Members wrote to Mexico's ambassador to Washington, calling for immediate action to reach agreement on the outstanding issues that remain and that benefits all affected parties on both sides. Their letter noted the consequences of no deal "will undoubtedly jeopardize a very large and growing agricultural trade relationship under the NAFTA." Senator Grassley on August 11 announced plans to hold a Finance Committee hearing this fall on

Mexico's soft drink tax and other Mexican trade barriers to U.S. farm products. At the same meeting with Iowa farmers, U.S. Trade Representative Zoellick raised the possibility that the United States may initiate a WTO dispute resolution case on Mexico's tax on soft drinks sweetened with HFCS as a way to leverage a resolution to both sweetener disputes.

Circumvention of Sugar Import Quotas

The sugar production and cane refining sectors in the 107th Congress pursued a legislative remedy to prevent U.S. firms from taking advantage of tariff "loopholes" to import sugar outside of (to "circumvent") the existing sugar and sugar-containing product (SCP) TRQs. This initiative was one of the three "pillars" the production sector had sought to achieve a sugar policy that accomplished their objective of achieving a supply-demand balance that protects their interests. Sugar producers, processors, and refiners, citing the "stuffed molasses" case as a prime example, argued that imports of some sugar mixtures and products undermined the domestic sugar industry by adding to the sugar surplus.

During Senate Finance Committee markup of trade adjustment assistance legislation (S. 1209) on December 4, 2001, Members approved an amendment offered by Senator Breaux to authorize USDA to identify imports that are circumventing the TRQs on sugars, syrups, or sugar-containing products, and to require the President to include such-identified products in proclaiming revisions to these quota provisions. This provision was included in the trade promotion authority and adjustment assistance legislative package (Section 1002 of H.R. 3009) the Senate passed on May 23, 2002. There was no comparable provision in the trade bill package agreed to by the House. House and Senate conferees subsequently reached agreement on July 26 on a compromise to the Senate provision. The conference report clarified that certain products containing molasses were to be made subject to a specific sugar TRQ, but pared back the scope of the Senate language to also include U.S. Customs in monitoring such imports and to retain flexibility for the executive branch and Congress on how any identified circumvention is to be handled (Section 5203 of P.L. 107-210). The compromise language, depending on how implemented, initially may serve to stop the flow of easily identifiable "stuffed molasses"-like products. Most observers, though, do not view it as sweeping in scope compared to the language initially introduced.

The conference-adopted language requires U.S. Customs and USDA to submit a report to Congress every 6 months to report their findings on whether there are any indications that imports are causing any circumvention of the sugar and SCP TRQs. In their first report to Congress dated February 5, 2003, they found no evidence to suspect any significant level of fraudulent imports in FY2002, nor any cause to suspect legal imports were impeding USDA's ability to manage the program. In the second report (August 2003), USDA identified that imports of sweetened cocoa powder entering from Mexico were circumventing the U.S. sugar TRQ. Its analysis described how Mexican manufacturers of high sugar content products were using low-priced sugar accessed under the U.S. and Mexican sugar re-export programs, to export sweetened cocoa powder to the U.S. market. USDA listed the three steps taken since March 2003 to address this issue, and had no recommendations for congressional action.

As background, a coalition of food groups opposed the initial Senate-passed provision, arguing that it represented "a direct attempt to close the borders to lawfully imported sugar containing products." It pointed out that the amendment was so broadly written that food products that contain sugar, such as gelatin or ice tea mix, could be placed under a TRQ, despite its stated intent to target only those products that "circumvent" TRQs. The coalition claimed the wording failed to define "circumvention," gave USDA "no effective guidance" on how to identify products for reclassification in a TRQ, allowed for no review by the President or the courts of USDA determinations, and undermined the Department of Treasury's role in administering tariff laws by creating an exception for sugar-containing products. This coalition stated the amendment could violate U.S. trade agreements and invite foreign retaliation. Sixty House members laid out these same arguments in a late June letter to House trade bill conferees, and asked that they reject the Senate amendment in conference.

The sugar industry argued the Senate provision would enhance the function that TRQs perform in U.S. sugar policy by establishing a process to protect the industry from the impact of products containing sugar being imported into the United States in forms that have no commercial use. *Inside U.S. Trade* reported that one industry source stated the language "does not cover any finished products or any products with any commercial use in the form in which it is imported." The food group coalition, though, countered that the wording would require USDA to identify imports of manufactured food products found in four chapters of the Harmonized Tariff Schedule as circumventing the sugar and related product TRQs. The sugar industry claimed the provision would protect the market access of those countries with a share of the U.S. sugar TRQ by ensuring that their sales of sugar do not decline as a result of sugar-containing products entering intentionally to circumvent the TRQ.

Sugar in Trade Agreement Negotiations

Whether, and on what terms, to liberalize trade in sugar and sugar-containing products in prospective trade agreements could prove to be a contentious issue for U.S. negotiators. Exporting countries have signaled they want these agreements to provide increased access for their sugar to the higher-priced U.S. market. The U.S. sugar production sector is concerned that any additional entry of sugar and products under bilateral and regional trade agreements would undermine its market share, threaten the viability of the domestic sugar program, and result in significant loan forfeitures. U.S. manufacturers which use sugar in food products and beverages favor opening up the domestic market to additional imports, foreseeing that the resulting lower sugar prices would benefit them and consumers.

Sugar trade is expected to be more of an issue in negotiating the hemispheric Free Trade Area of the Americas (FTAA) and bilateral free trade agreements with five Central American countries, four southern African countries, Australia, and the Dominican Republic, than in multilateral efforts to reach an agreement on the pace and terms of liberalizing agricultural trade under the WTO framework. With Brazil, Guatemala, South Africa, and Australia viewed as major low-cost sugar producing and exporting countries, free trade agreements (FTAs) that the United States might enter into with them conceivably could allow for additional sales of sugar to the U.S. market than now permitted under their allocated shares of the U.S. sugar TRQ. Brazil's negotiators frequently mention that increased market access for its sugar in the U.S. market is one of their key priorities in the FTAA. Since the inherent objective of any free trade agreement is to eliminate all border protection on all imports (including agricultural commodities) within some specified time period, the scenario of removing current U.S. quota provisions and tariffs on imports of sugar and sugar containing products from countries that are signatories to these agreements would in time result in additional U.S. sugar imports and undermine the operation of the domestic sugar program.

This scenario assumes the U.S. domestic price remains significantly higher than the world sugar price, with this difference (or price premium) serving as the incentive for exporters to sell to the U.S. market rather than to the rest of the world. By contrast, any multilateral agreement that emerges from the WTO's Doha Development Round will reduce to some extent those trade-distorting policies used by countries to support their sugar and other commodity sectors. The degree to which such reductions might occur will only become apparent when negotiators settle upon the parameters and process that each country will need to follow to develop specific reductions in trade distorting policies (including those in sugar sectors) to arrive at a broad multilateral agreement by late 2004. The inability of WTO members to agree on these "modalities" heading into the Cancun Ministerial Summit in September 2003, clouds the prospect for an agreement in the agreed upon time frame, according to some observers. Any text and accompanying schedules, though, that may emerge are not expected to require the complete phasing out of such policies in all countries' sugar sectors, and thus would affect the U.S. sugar sector likely only at the margin.

The American Sugar Alliance (ASA) representing sugar crop farmers and processors argues that the Bush Administration's efforts should be to "reform the world sugar market through comprehensive, sector-specific WTO negotiations" and not through regional or bilateral trade agreements. ASA supports the goal of global free trade (including for sugar) through the WTO, which it views as the best venue for addressing "the complex array of government policies that distort the world sugar market" on a multilateral and comprehensive basis. Spokesmen frequently mention subsidies that various countries use to "encourage the dumping of sugar at a fraction of what it costs to produce it." To support its position, ASA released in January 2003 a commissioned report it says documents the non-transparent and indirect subsidies that major sugar producing and exporting countries use to assist their sugar sectors. For this reason, ASA opposes negotiating sugar trade provisions in regional agreements because it claims the most damaging government policies (citing Brazil's sugarcane-ethanol subsidies, the Mexican government's ownership of sugar mills, and the European Union's (EU) sugar export subsidy regime) will not be addressed by the FTAA negotiations. It also fears that sizable sugar exports from Central American countries would injure U.S. sugar producers and not benefit consumers in the form of lower prices.

The Sweetener Users Association (SUA) (comprised of industrial users of sugar and other caloric sweeteners and the trade associations which represent them) and the Coalition for Sugar Reform (CSR) (trade associations for food and beverage manufacturers, some cane refiners, taxpayer advocacy organizations, environmental groups and consumer organizations that advocate reform of U.S. sugar policies) support the Bush Administration's proposal tabled at the WTO to further liberalize agricultural trade as well as its negotiating objectives in the FTAA and bilateral FTAs. The proposal to the WTO, submitted in July 2002, calls for countries to eliminate export subsidies, reduce tariffs on any agricultural product to not more than 25%, and expand the in-quota amount of current tariff-rate quotas (TRQs) by 20%. SUA expects that under this proposal "world sweetener markets will operate more efficiently and fairly," as EU's export subsidies are phased out and U.S. sugar import quotas become more market oriented. Both groups argue that liberalizing trade in sugar would benefit the U.S. economy through lower prices, encourage product innovation and stimulate demand, keep food manufacturing jobs in the United States rather than see them move overseas, help maintain a viable cane refining industry with its well-paid union jobs, and stimulate competition and thus thwart excessive industry concentration.