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Sugar Policy Issues

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SUMMARY

The sugar program, authorized by the 2002 farm bill (P.L. 107-171), is designed to protect the price received by 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) makes loans available at minimum price levels to processors, limits the amount of sugar that processors can sell domestically, and restricts imports.

Sugar crop growers and processors stress the industry's importance in providing jobs and income in rural areas. Food and beverage manufacturers that use sugar and their allies argue that U.S. sugar policy imposes costs on consumers and results in lost jobs at food firms in urban areas. Since 2002, producers and users have advanced their interests by seeking to influence how USDA administers the sugar program and the import quota.

The 2002 farm bill reactivated sugar "marketing allotments" to limit the amount of domestic-produced sugar that processors can sell. Because the level at which USDA sets the national sugar allotment quantity has implications for sugar prices, sugar producers and processors, and sugar users, weigh in to influence this decision.

Congressional debate on the Dominican Republic-Central American Free Trade Agreement (DR-CAFTA) focused attention on the relationship between marketing allotments and U.S. sugar imports. Opponents argued DR-CAFTA will let more sugar into the U.S. market than the program is designed to accommodate, and require USDA to suspend marketing allotments. This in turn, they argued, would depress prices enough to undermine USDA's ability to operate a "no-cost" program. USDA argued this would not occur, but to secure sufficient votes, pledged to take specific steps to protect the program through FY2008 if imports do exceed this "trigger." To meet demand the U.S. sugar sector could not supply due to reduced weather-related output, USDA (under a statutory exception) increased imports in FY2005 and FY2006 to above the trigger level without suspending allotments.

The U.S. sugar production sector argues that liberalizing trade in sugar should be addressed in multilateral World Trade Organization negotiations, but not in hemispheric and bilateral free trade agreements (FTAs). Its concern is that additional market access provided to prospective FTA partners, many of which are major sugar exporters with weak labor and environmental rules, would undermine the U.S. sugar program and threaten the sector's viability. Sugar users advocate the inclusion of sugar in all trade negotiations, eyeing the prospect over time of lower-priced sugar they have not been able to secure through floor amendments.

The sugar provisions in DR-CAFTA drew much attention during congressional debate. Strongly opposed by the U.S. sugar producing sector but favored by most other U.S. commodity groups, the debate drew attention again to the sugar provisions in the North American Free Trade Agreement. Free trade in sugar between Mexico and the United States will take effect in January 2008 despite two longstanding trade disputes. The prospect of unrestricted sugar imports from Mexico starting in 2008, added to sugar imports under DR-CAFTA and other possible trade agreements, will be one significant issue in the debate on the future of the sugar program as Congress begins deliberating the 2007 farm bill.

Most Recent Developments

On May 10, 2006, the Senate Agriculture Committee held a hearing to review the implementation of the sugar provisions of the 2002 farm bill. The U.S. Department of Agriculture's Undersecretary stated that the sugar program operated relatively smoothly through July 2005, but characterized it as "highly prescriptive, containing many rigid, and sometimes contradictory, rules" that increased the complexity of program administration. He noted that developments in the U.S. and Mexican sugar sectors after NAFTA takes full effect in January 2008 mean "alternative [sugar policy] approaches will need to be explored." Anticipating upcoming debate on the next farm bill, sugar crop growers, processors, and most cane refiners stated that they will seek an extension of the current program, arguing that existing policy works well and has provided supply stability. Sugar users (food and beverage manufacturers) called for changes that would allow the program to operate more flexibly, and want to "explore common ground" with the sugar producing sector. The president of the only independent cane refinery expressed concern about two issues that current policy does not handle well, which he would like addressed in the 2007 farm bill. A spokesman for the sugar industry of Mauritius, one of the 40 countries with a share of the U.S. import quota, emphasized how important continued access to the U.S. market is for the stable revenue flow and positive developmental impact provided by the U.S. program's price premium.

Background and Analysis

History of and Background on 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 sugar consumption and divide this market by assigning quotas to U.S. growers and foreign countries. These Acts also 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. For the next seven years, the U.S. market was relatively open to foreign sugar imports, with mandatory price support provided only in 1977 and 1978, and discretionary support in 1979. Congress reinstated mandatory price support for sugar in the Agriculture and Food Act of 1981 and the Food Security Act of 1985. Subsequently, the 1990 farm bill, the 1993 budget reconciliation bill, and the 1996 and 2002 farm bills extended sugar program authority, with the last through the 2007 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 has grown over the last 25 years, reflecting the price protection provided by the sugar program. In FY2005, domestic production filled 86% 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 later in that decade, foreign suppliers absorbed the entire adjustment and saw their share of the U.S. market decline significantly. The import share of U.S. sugar food use in FY2005 was 14%.

Current U.S. sugar policy maintains domestic sugar prices above the world market price, and is structured to protect the domestic sugar producing sector (sugar beet and sugarcane producers, and the processors of their crops) and to ensure a sufficient supply. During 2005, the U.S. raw sugar domestic futures price averaged 21.3¢/lb., compared to the world raw sugar futures price of 11.4¢/lb. Because of the price differential, U.S. consumers and manufacturers of foods and beverages pay more for sugar than they would if imports were allowed to enter without any restriction. Various studies show that over the last 15 years, U.S. sugar users paid $400 million to $1.9 billion more for sugar annually. These "cost to user" estimates vary widely, and largely reflect the extent of the difference between the higher U.S. price and the lower world price for sugar in the time period examined, and the differing assumptions and methodology analysts use to develop such estimates.

The sugar program differs from grains, rice, peanut, and cotton programs in that USDA makes no direct payments to beet and cane growers and processors. Structured this way, taxpayers do not directly support the program through federal government outlays. This fact is highlighted as a positive feature by the sugar production sector and program 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.

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, HFCS manufacturers and the corn producers that supply them, and the federal government.

Main Features of U.S. Sugar Policy

U.S. sugar policy uses two tools to ensure that domestic growers and sugar processors receive a minimum price for their sugar. This price is largely determined by the statutorily-set loan rate. "Marketing allotments" limit the amount of domestically-produced sugar that can be sold when imports are estimated below a specified level. Import quotas restrict the amount of foreign sugar allowed to enter the U.S. market. USDA decisions in administering these tools are intended to balance available sugar supply (i.e., domestic output plus imports) with U.S. food demand for sugar so that market prices do not fall below effective support levels. The 2002 farm bill requires USDA to operate the sugar program on a "no-cost" basis (i.e., result in no federal government outlays).

Price Support Loans

USDA extends "non-recourse" price support loans to processors of sugarcane and sugar beets rather than directly to the farmers who harvest these crops. Loans are available only to processors who agree to pay growers for deliveries of sugar beets and sugarcane at USDA-set minimum payment levels. Their "non-recourse" feature means a processor can exercise the legal right to hand over sugar it initially offered USDA as collateral for the loan to meet its repayment obligation, if the market price is below the effective support level when the loan comes due. These loans at times can be 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 through the 2007 crop year, at 18¢/lb. for raw cane sugar and 22.9¢/lb. for refined beet sugar. These rates have not changed since 1995. The loan support for beet sugar is set higher than for raw sugar because it is available immediately after processing in refined form, ready for industrial food and beverage use and for human consumption. By contrast, raw cane sugar must go through a second stage of processing at a cane refinery to be converted into white refined sugar.

Effective Support Levels. The above loan rates do not serve as the intended price floor for sugar. In practice, USDA's aim is to support the raw cane sugar price at not less than 19.9¢ to 21.0¢/ lb. (i.e., the state's price support level *plus* an amount that covers a processor's cost to transport 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 22.9¢ to 25.2¢/lb. (i.e., the regional loan rate *plus* specified marketing costs *plus* interest paid on a price support loan *plus* a cash discount). To ensure that market prices do not fall below these "loan forfeiture," or "effective" price support, levels, USDA administers sugar marketing allotments and import quotas. A loan forfeiture (turning over sugar pledged as loan collateral to USDA) occurs if a processor concludes that the domestic market price when the loan comes due is below the "effective" sugar support level for its state or region. It is this level — not the loan rate — that represents the minimum level of program benefits intended for sugar crop growers and processors.

Marketing Allotments

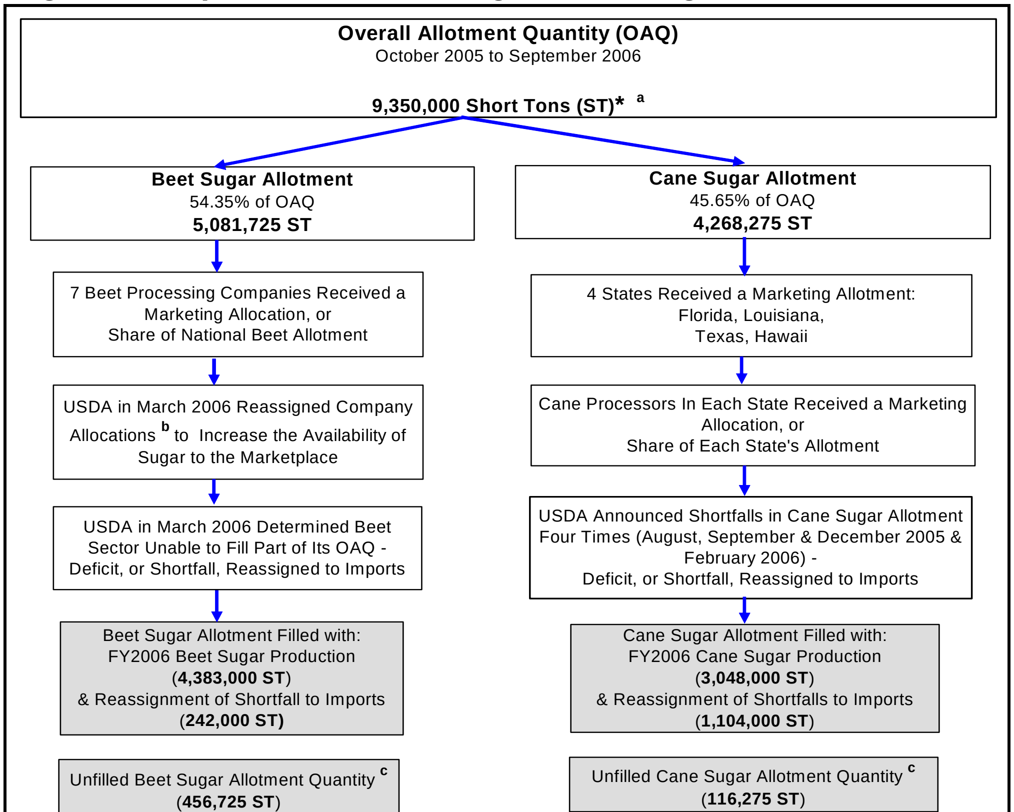
The 2002 addition of marketing allotments to support domestic sugar prices reflected the sugar production sector's willingness to accept reduced sales in return for the assurance of price protection. Allotments serve as a tool to ensure that any growth in U.S. sugar demand is first met by the U.S. sugar sector, and to guarantee the beet and cane sectors each a specific share of the U.S. market. By regulating the amount of sugar that processors can sell, USDA meets the program's no-cost objective by keeping market prices above effective support levels, and thus not acquiring sugar as a result of any loan forfeitures.

Allotments Required When Sugar Imports Are Below 'Trigger' Level. USDA is required to announce marketing allotments when it projects annual sugar imports will be *below* 1.532 million short tons (ST) — referred to as the "trigger level." By limiting the amount of sugar that beet sugar refiners and raw cane mills can sell, this mechanism ensures that the United States meets its market access commitments for sugar imports under the World Trade Organization (WTO) and NAFTA agreements (see "Import Quotas").

USDA must weigh several factors to calculate the amount of domestic sugar that can be sold (the "overall allotment quantity" or OAQ) — (1) estimated consumption, (2) "reasonable" ending stocks, (3) domestic production, (4) beginning stocks, and (5) imports for human consumption. The formula that USDA uses to determine the OAQ must accommodate imports under both trade agreements up to the 1.532 million ST level. USDA can further adjust the OAQ if necessary to avoid loan forfeitures. Second, the OAQ must be split between the beet and cane sectors using 54.35% and 45.65% shares, respectively. Rules that differ between the cane and beet sectors specify how each of their allotments is to be allocated (i.e., distributed) to each firm. Once detailed calculations are made, each firm can sell only as much sugar as stated in its allotment notification received from USDA. Sugar produced in excess of a firm's allotment must be held off the market (referred to as "blocked stocks"). **Figure 1** illustrates how USDA is implementing marketing allotments for FY2006, the second year it has implemented some of the less-known features of this authority.

The USDA initial determination of the OAQ by August 1st for the marketing year that begins October 1, and any subsequent adjustments, are the most significant decisions made in implementing marketing allotment authority. Accordingly, sugar processors and food manufacturers (e.g., users of sugar) weigh in to influence USDA's decision-making process on this issue. Each group differs in how USDA should define "reasonable" ending stocks

Figure 1. Implementation of Sugar Marketing Allotments, FY2006



* One ST equals 2,000 lbs.

[a] OAQ shown reflects two increases from the initial 8,600,000 ST level announced on August 12, 2005.

[b] Transferred from those companies that did not have enough sugar to sell (i.e., fill their FY2006 allocation), to those companies that had sugar to sell against their unfilled allocation.

[c] Equals amount not available from FY2006 production to be marketed. Depending on market conditions, USDA could reassign this shortfall to imports later in the year.

Notes: Reflects USDA decisions and U.S. sugar supply and demand status, as of May 12, 2006.

— a key determinant of the level of domestic sugar prices in the last quarter of the marketing year (July to September) when price support loans come due. However, USDA must estimate a year in advance (even though market conditions can change much during this period) an OAQ level intended to result in market prices 12 months later that are above effective support levels. Sugar processors favor a smaller OAQ, hoping to benefit from sugar prices well above effective support levels. Food manufacturers advocate a larger OAQ, hoping that year-end prices end up lower, close to loan forfeiture levels.

Allotments Suspended When Imports Exceed Trigger Level. If USDA estimates sugar imports will be *above* 1.532 million ST, USDA must suspend marketing allotments (with the one exception noted below). If allotments are triggered, USDA is still required to make available price support loans to raw cane sugar processors and beet sugar refiners. Suspending allotments, though, could raise considerable uncertainty for domestic sugar prices. Depending upon the U.S. sugar production and food use outlook at that point in time, and estimated imports of sugar for food consumption, price scenarios could vary considerably. If sugar processors use the suspension to release blocked stocks of sugar, sugar prices (depending upon the additional import amount and the amount of stocks released) could decline to below loan forfeiture levels. This would likely result in USDA acquiring sugar from those processors that decide not to repay their loans. If U.S. demand for sugar is higher than can be met by the domestic sugar sector (either from projected output and/or blocked stocks), prices as additional imports enter under a suspension could very well rise, and likely stay above loan forfeiture levels.

Exception to Suspending Allotments. A little-noticed exception in the law allows USDA not to suspend allotments when additional imports exceed the trigger level, because the beet or cane sector is unable to supply sugar against their allotment. Since the law does not allow, for example, a cane sugar "deficit" to be met with any available "surplus" of beet sugar, USDA can "reassign" such an allotment deficit, or "shortfall," to imports. This occurred three times late in FY2005, and four times in FY2006, when USDA reassigned allotment deficits to imports in order to alleviate a tight supply situation (see "Import Quotas" and **Figure 1** for more on the relationship between allotments and imports).

FY2006 Allotment Announcements. On February 2, 2006, USDA increased the FY2006 OAQ to 9.35 million ST, in order to respond "to a continuing tight sugar market" caused largely by Hurricanes Katrina, Rita, and Wilma that reduced domestic supplies. This decision allows both the beet and cane sectors (unlike previous years) to sell all of their currently-estimated FY2006 sugar output against their allotment share of the OAQ. To meet the balance of U.S. sugar demand this year that cannot be met from domestic sources, USDA reassigned the large cane sector's and small beet sector's "allotment shortfall" to imports (**Figure 1**). On September 30, 2005, USDA announced the initial details of FY2006 marketing allocations for beet processing companies. Cane state allotments and processor allocations will be announced later when the company-specific impacts from all of last summer's hurricanes become more clear.

Import Quotas

USDA restricts the quantity of foreign sugar allowed to enter the United States for refining and sale for domestic food and beverage use. 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 thus not acquire sugar due to loan forfeitures (i.e., meet the "no-cost" requirement). Though the sugar import quotas are not directly addressed by farm bill provisions, USDA and the Office of the U.S. Trade Representative (USTR) administer them as an integral part of the sugar program.

Tariff-rate quotas (TRQs) are used to restrict sugar imports to the extent needed to meet U.S. sugar program objectives. The U.S. market access commitment made under 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 (as occurred in FY2005 and FY2006). In addition, the United States is committed to allow sugar to enter from Mexico under NAFTA provisions. The complex terms are detailed in a schedule and a controversial side letter, which lay out the rules and the formula to calculate how much sugar Mexico can sell to the U.S. market. Through FY2008, the maximum amount that can enter from Mexico is 276,000 ST (see "Sweetener Disputes with Mexico — Mexico's Terms of Access to the U.S. Sugar Market," below). Under the WTO agreement, foreign sugar enters under two TRQs — one for raw cane, another for a small quantity of refined sugar. Under the NAFTA TRQ, and DR-CAFTA TRQ expected to take effect in stages during 2006, sugar can enter either in raw or refined form.[1]

The USTR allocates the WTO TRQs among 41 eligible countries, including Mexico and Canada. The amount entering under 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 (78% in 2003, according to the International Trade Commission), serving to protect the U.S. sugar-producing sector from the entry of additional foreign sugar. The tariff (equivalent to about 10% in 2006) on above-quota sugar entering from Mexico under NAFTA continues to decline, and will reach zero in January 2008. 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).

FY2006 Import Quota Decisions. USDA to date has set the FY2006 WTO raw and refined TRQs for sugar imports at 2.33 million ST, a level 86% above the U.S. minimum WTO commitment. On September 29, 2005, USDA announced a separate sugar TRQ of 268,000 ST for Mexico, having determined that it is a net 'surplus producer' under NAFTA's terms. The increases in both the WTO and NAFTA sugar TRQs to levels above what would occur in a typical recent year represent USDA decisions to boost short-term supplies to address a tight supply situation caused by the delayed sugar beet harvest in North Dakota and Minnesota, hurricane-related losses to Louisiana's and Florida's sugarcane crops, and the related closure until December 2005 of a large sugar cane refinery in Louisiana.

Sugar Imports, the Allotment Suspension Trigger Level, and DR-CAFTA. One concern raised during the congressional debate on DR-CAFTA was that the additional

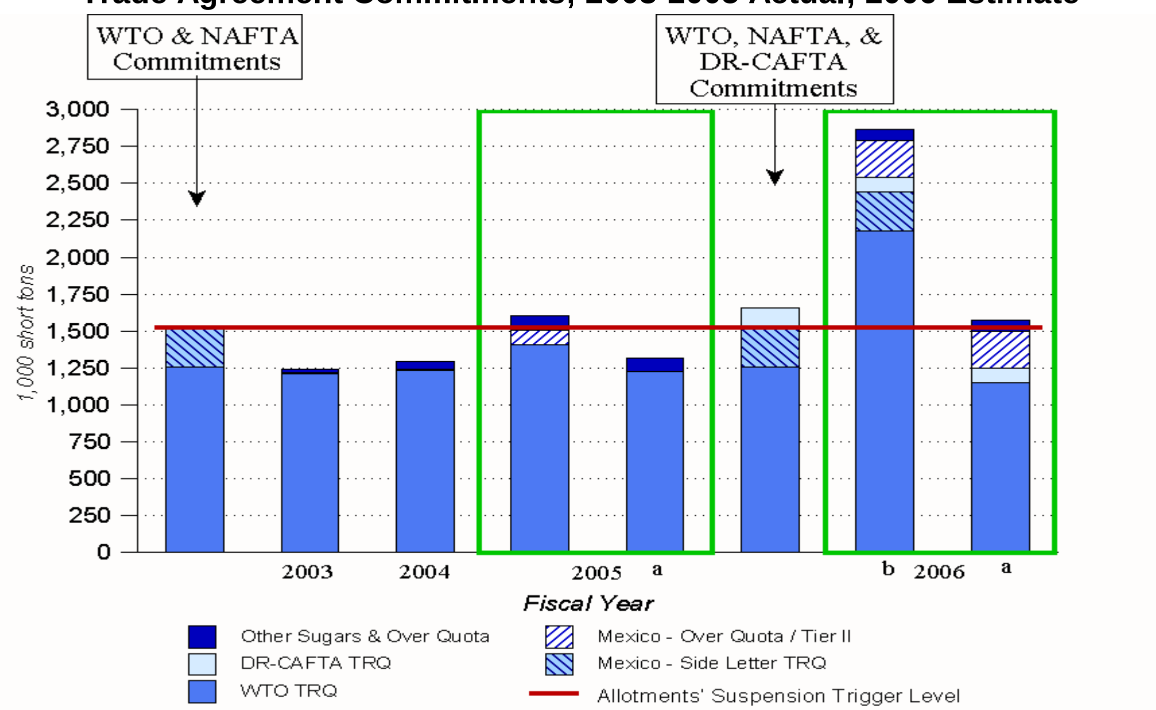
[1] A TRQ combines two policy instruments used to restrict imports: quotas and tariffs. The quota component works together with a specified tariff level to provide the desired degree of import protection. Imports entering under the quota portion of a TRQ are usually subject to a lower, or sometimes a zero, tariff rate. This "in-quota" amount represents the minimum that a country has committed to allow to enter under multilateral or other trade agreements. Imports above the quota's quantitative threshold (referred to as "above-quota") face a much higher (usually prohibitive) tariff.

amount of sugar that would enter, when added to existing U.S. sugar access commitments under the WTO and NAFTA agreements, would exceed 1.532 million ST — the trigger for suspending marketing allotments. Some pointed out that adding the DR-CAFTA's first year access commitment to those in the two existing trade commitments would result in a sugar import level of 1.652 million ST (**Figure 2**).

Sugar imports in the first two years of current sugar program authority (FY2003 and FY2004) were well below the trigger level. For FY2005 and FY2006, sugar imports are above this level, but not result in the suspension of allotments because USDA has determined additional imports are needed to meet U.S. sugar demand. USDA decided late in FY2005 to allow additional imports to add to tight domestic supplies. This resulted in imports of 1.6 million ST — 68,000 ST above the trigger level. However, because much of the late-year increase in imports was due to the inability of the cane sugar sector to fully utilize its increased allotment, these imports (used to cover the cane allotment "shortfall") do not count against the trigger level. For FY2006, USDA projects lower sugar output for the same reasons identified above, and has already reassigned increases in the cane and beet allotment deficits to imports to boost the availability of both raw and refined sugar. Taken together, these decisions (plus imports expected under DR-CAFTA) equal currently projected FY2006 sugar imports of 2.865 million ST — 1.333 million ST above the trigger level (**Figure 2**), but will not result in the suspension of allotments (see "Exception to Suspending Allotments" above).

The issue of the potential impact of sugar imports on the U.S. sugar program under DR-CAFTA has receded for now, because USDA factored these imports into setting the FY2006

Figure 2. U.S. Sugar Imports Compared to Allotment Suspension Trigger: Trade Agreement Commitments; 2003-2005 Actual; 2006 Estimate



Source: USDA (selected reports and press releases), and CRS calculations

[a] Adjusted for USDA's formal reassignments of beet and cane allotment deficits to imports.
[b] Reflects TRQ announcements and USDA estimates, as of May 12, 2006.

OAQ. Looking ahead, whether sugar imports in FY2007 and FY2008 activate the trigger to suspend allotments will depend on how quickly domestic sugar production (particularly in the hurricane-affected cane sector) recovers, and the extent to which imports serve to cover any allotment "deficits." The issue of whether allotments might be suspended if imports result in more sugar than the U.S. market needs (i.e., exceeds the trigger level), though, may be made moot by a pledge made by the Secretary of Agriculture during congressional debate on DR-CAFTA. In a letter to the chairmen of the House and Senate Agriculture Committees, he specified the steps he will take to ensure the sugar program operates as authorized through FY2008 if he estimates imports under DR-CAFTA, NAFTA, and other trade agreements exceed the trigger level (see "Sugar in DR-CAFTA — Sugar Deal to Secure Votes," below).

Other 2002 Farm Bill Provisions

Another farm bill change authorizes 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, and could again be used to meet the program requirement that the sugar program operate on a no-cost basis.

Other changes: (1) increased the effective price support level by 5%-6% by repealing the approximate 1¢/lb. loan forfeiture penalty, (2) broadened the coverage of the loan program to allow non-recourse loans to be made also for in-process sugars and syrups at 80% of the raw cane or refined beet loan rate, (3) repealed the sugar marketing assessment retroactively to October 1, 2001 (saving the production sector about $40 million annually), (4) authorized 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, and (5) reduced the interest rate USDA charges on price support loans extended to sugar processors by 100 basis points (1%). USDA chose not to implement the last provision, based on its interpretation of the text.

Sugar Program in the 2002 Farm Bill

Congressional debate over sugar policy leading up to the 2002 farm bill changes took place against the backdrop of structural changes in the industry, domestic sugar prices low enough in 1999 and 2000 due to an oversupplied market that made it attractive for processors to forfeit on some price support loans and hand sugar pledged as collateral to USDA as payment, and the inability at times of policymakers using the 1996-enacted U.S. sugar program framework to reconcile the twin objectives of protecting the domestic sugar price (under the sugar program) and meeting trade agreement obligations that allow foreign sugar to enter the U.S. market (under the import quota).

The enacted 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 allotment mechanism, and remove the federal government's budgetary exposure. The sugar production sector's objective, expecting little growth in domestic sugar demand and accepting U.S. sugar import commitments in effect at that time, 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.

The nearly identical sugar programs reported out by the House and Senate Agriculture Committees were challenged by program opponents during floor debate. Program opponents on the floor in both the House and Senate failed in their 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 the repeal of the 1996-enacted approximate one-cent penalty imposed on a processor that forfeits any price support loan taken out.

The 2002 farm bill's sugar provisions reflected the recommendations offered by the American Sugar Alliance (ASA) representing sugar farmers and processors. Upon passage, the ASA commented that the reinstated U.S. sugar policy "will ensure stable prices for farmers and consumers and operate at no cost to taxpayers." It viewed 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 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, "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 [it] at their expense until the market requires it."

The Coalition for Sugar Reform representing food and beverage manufacturers, consumer and taxpayer advocacy groups, environmental organizations, and the then publicly-traded cane refiners, supported the House amendment to replace the Agriculture Committee's proposed sugar program with an approach it argued would result in a sugar policy more oriented to market forces. The Coalition had 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 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."

Legislative Activity in the 109th Congress

Amendment to Agriculture Appropriations. During floor debate on the FY2006 agriculture appropriations bill (H.R. 2744), the House rejected on a vote of 146 ayes to 280 noes an amendment offered by Congressman Blumenauer to effectively reduce the loan rates by about 6%, to not more than 17¢/lb. for raw cane sugar and 21.6¢/lb. for beet sugar. He argued that most of the program benefits go to large producers and to an industry that makes it difficult to reach trade agreements with other countries. Opponents countered that any vote on a proposed program change should occur when the 2007 farm bill is considered.

Budget Reconciliation. Conferees, in completing action on the FY2006 budget reconciliation bill (S. 1932) in mid-December 2005, dropped a Senate provision that would have assessed a penalty on non-recourse sugar loans forfeited by a sugar processor, equal to 1.2% of the loan rates for raw cane and refined beet sugar. This would have represented the sugar sector's contribution toward budget deficit reduction targets. A similar penalty was an integral part of the sugar program authorized by the 1996 farm bill.

Sugar Trade Issues

The United States imports sugar to cover the balance of its domestic food needs (14% in FY2005) that are unmet by the U.S. sugar production sector. Sugar imported under market access commitments made by the United States in trade agreements or under prospective free trade agreements (FTAs), together with a growing increase in imports of sugar-containing products not subject to import restrictions, can increase available sugar supplies and push prices down. Increases in sugar imports, though, can also serve to dampen any rise in domestic sugar prices, particularly when domestic sugar output falls.

Sugar in Trade Agreement Negotiations

Whether, and on what terms, to liberalize trade in sugar and sugar-containing products in prospective trade agreements is a difficult issue that U.S. negotiators face. With the U.S. sugar price higher than the world sugar price, exporting countries want these agreements to provide increased access for their sugar to benefit from the more lucrative U.S. price. The U.S. sugar production sector opposes any additional entry of sugar and products under bilateral and regional trade agreements. It is concerned increased imports would undermine its market share, threaten the viability of the domestic sugar program, and result in significant loan forfeitures. U.S. manufacturers that use sugar in food products and beverages favor opening up the U.S. market to additional imports, anticipating lower sugar prices over time.

Sugar trade is more of an issue in negotiating bilateral and regional FTAs than in multilateral negotiations under the WTO. With Brazil, Colombia, Guatemala, and Thailand being major low-cost sugar producing and exporting countries, FTAs with them could allow for additional sales of sugar to the U.S. market above levels now permitted under their 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 agricultural priorities in the pending hemispheric Free Trade Area of the Americas (FTAA). Since the U.S. objective in negotiating an FTA is to eliminate eventually all border protection on all imports, the removal of current U.S. quotas and tariffs on imports of sugar and sugar-containing products could begin to undermine the operation of the domestic sugar program as now structured (e.g., make it not possible for USDA to operate it at "no-cost"). By contrast, any multilateral agreement that emerges from the WTO negotiations could reduce trade-distorting policies that countries (including the United States) use to support their sugar and other commodity sectors (see "Sugar in WTO Negotiations").

Key Interest Group Views. 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 comprehensively addressing "the complex array of government policies that distort the world sugar market". ASA contends that the subsidies used by many countries "encourage the dumping of sugar at a fraction of what it costs to produce it." To support its position, ASA released in 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 including sugar market access provisions in FTAs, arguing that 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 bilateral or regional negotiations. It further argues that U.S. consumers would not benefit in the form of lower prices from increased imports under such agreements. ASA opposed the DR-CAFTA and has argued against including sugar in all other FTAs in hearings before USTR and the ITC.

The Sweetener Users Association (SUA — composed of industrial users of sugar and other caloric sweeteners and the trade associations that represent them) have consistently supported the Bush Administration's proposals tabled at the WTO to further liberalize agricultural trade. SUA expects that under trade liberalization, "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. SUA argues that liberalizing trade in sugar would benefit the U.S. economy through lower prices, keep food manufacturing jobs in the United States rather than see them move overseas, and help maintain a viable cane refining industry with its well-paid union jobs. It also contends increased imports would encourage product innovation and stimulate demand, stimulate competition, and thwart excessive industry concentration. The SUA supported DR-CAFTA and favors the Administration's objectives in the other bilateral FTAs, the FTAA, and WTO talks.

Sugar in DR-CAFTA. The sugar provisions in DR-CAFTA were among the most hotly debated issues during congressional consideration in the summer of 2005. The U.S. sugar industry strongly opposed DR-CAFTA, arguing that the amount of increased access offered the six countries "would destroy the U.S. sugar industry." Spokesmen emphasized that the increased imports would depress domestic sugar prices, make it impossible to operate the U.S. sugar program on a no-cost basis, increase government costs as processors forfeit on their price support loans, and "drive efficient American producers out of business." While acknowledging that the Administration understood the consequences of reducing the over-quota tariff, one industry spokesperson pointed out that under the current sugar program, additional imports would act to displace domestic sugar output. The sugar industry also feared that approving DR-CAFTA would set a precedent for U.S. negotiators to include sugar in other FTAs being negotiated with several sugar exporting countries (see "Sugar in Prospective FTAs"). It pointed out total sugar export availability of actual and potential FTA candidates is 27 million metric tonnes (MT), compared with U.S. sugar output of 8 million MT. The Sweetener Users Association supported the DR-CAFTA, stating it will enhance competition in the U.S. sugar market, increase export opportunities for other U.S. food and commodity sectors in the six countries, and result in increased employment in U.S. confectionery and other sugar-using industries.

The six countries covered by this agreement (Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua) are allowed to sell to the United States a combined minimum of 311,700 MT of sugar annually under an allocation, or share, of the

TRQ. This amount represents a 28% share of the entire U.S. raw sugar TRQ (1.12 million MT) established under its WTO commitment, and enters on a duty-free basis. Under DR-CAFTA, these six countries together secured access in year 1 to export to the U.S. market an additional 109,000 MT of sugar, a 35% increase over their current quota. Increasing on average about 3% per year, by year 15, these countries combined will be eligible to sell duty-free an additional 153,140 MT of sugar. Thereafter, the quota would increase by almost 2% (2,640 MT) annually in perpetuity. The over-quota tariff would stay at the current high level (78% in 2003) indefinitely, and not decline. The agreement includes a "compensation" mechanism that the United States can exercise at its sole discretion in order to manage U.S. sugar supplies. If activated, the United States commits to compensate the six countries for sugar they would not be able to ship under the above market access provisions.

In justifying DR-CAFTA's sugar provisions, U.S. Trade Representative officials pointed out that the additional access granted all six countries will equal about 1.2% of current U.S. sugar consumption in year 1, increasing to 1.7% in year 15. They also emphasized that the U.S. sugar sector will be protected by the compensation mechanism, the prohibitive tariff on above-quota imports, and the stipulation that a country can only export its net sugar surplus to the U.S. market. USTR's lead agricultural negotiator also stated that the import increase would not interfere with how sugar marketing allotments function.

Sugar Deal to Secure Votes. Under what circumstances, and how the sugar "compensation" mechanism might operate, drew much questioning when USTR officials testified before the Senate Finance Committee in April 2005. Several senators raised concerns about what would happen to sugar marketing allotments if USDA projects sugar imports, as a result of the additional imports under DR-CAFTA, will be above the trigger level that requires USDA to suspend allotments. To address these concerns, Secretary of Agriculture Johanns, on June 28, 2005, reached an agreement with two Senators that helped sway enough votes the next day in the Finance Committee for the DR-CAFTA implementing bill. In a letter to the chairmen of the House and Senate Agriculture Committees, the Secretary laid out the steps he would take to ensure the sugar program operates as authorized only through FY2008 if he estimates annual sugar imports under DR-CAFTA, NAFTA, and other trade agreements exceed the 1.532 million ST trigger level. These will include donating surplus commodities in USDA inventories or making cash payments as compensation to sugar exporters in Central America or Mexico to not ship sugar to the U.S. market under DR-CAFTA's and NAFTA's terms. The letter pledged that USDA would also divert (by purchasing) surplus sugar imports for ethanol and other non-food uses, and would complete a study to be submitted to Congress by July 1, 2006, on the feasibility of converting sugar into ethanol. Reactions by Members to the letter were mixed, with some skeptical about the assurance and others remaining opposed to DR-CAFTA, in part because of the costs that USDA would incur in meeting its pledge (as scored by the Congressional Budget Office). The U.S. sugar industry rejected USDA's commitment, calling it "a repackaged, short-term offer" that did not address its long term concerns about: (1) sugar that could enter in future trade agreements; (2) a resolution of the dispute on Mexico sugar access to the U.S. market; and (3) the continuation of the features of the current sugar program after FY2008.

FTA Negotiations with Australia. U.S. trade negotiators excluded sugar from the trade agreement concluded with Australia in February 2004. The sugar industry "applauded the Administration's decision to exclude market access commitments on sugar," pointing out a FTA can be negotiated without including sugar and that this can "serve as a template for all future FTA negotiations." The National Confectioners Association representing candy manufacturers "condemned" the negotiating results, stating that limiting access to Australian-produced sugar is "damaging" to U.S. candy firms and jobs. Other major commodity groups reacted that excluding sugar in negotiating other FTAs would harm their export interests.

Sugar in the Peru and Colombia FTAs. In the FTA with **Peru** announced in December 2005, U.S. negotiators offered access for an additional 11,000 MT of sugar to the U.S. market. This represents an almost one-fifth increase in Peru's minimum share of the U.S. raw cane TRQ (47,674 MT). Both the FTAs' preferential raw cane sugar quota would rise 2% each year, and the U.S. protective tariff on over-quota sugar would continue indefinitely. Peru would be permitted to ship sugar only if it has a net sugar surplus (i.e., sugar left over once its domestic market is supplied, and taking imports into account). This is expected to occur infrequently, in light of Peru's sugar trade flows in recent years. ASA signaled it would not oppose this agreement, noting the amount is "more reasonable than the excessive access granted in CAFTA." In the **Colombia** FTA concluded in February 2006, the United States offers access for an additional 50,000 MT of sugar. This represents a two-fold increase over Colombia's present minimum share of the U.S. raw cane TRQ (25,273 MT). The new quota would increase about 1.5% annually, and the high U.S. tariff on entries above the quota level would remain in place in perpetuity. ASA has held off taking a position, reportedly waiting to see what level of additional access to the U.S. market is agreed to when FTA negotiations with Panama, Ecuador, and Thailand are concluded. Both FTAs also include a sugar compensation provision similar to that found in DR-CAFTA.

Sugar in Prospective FTAs. One key U.S. principle in negotiating FTAs is that all commodities and economic sectors are on the table. However, coming to agreement on access for additional sugar to the U.S. market in current FTA negotiations with Ecuador, Panama, and Thailand will likely not be taken up until the very last moment in the process. U.S. negotiators have signaled that how they handle sugar will depend largely on the degree to which prospective FTA partners open up their markets to commodities that U.S. agriculture identifies to be of priority interest. These countries, though, view the latter as import sensitive, and will seek to protect them. The issue of sugar in each prospective FTA will likely include high-level discussions between the White House and foreign leaders, and Administration consultation with interested Members of Congress to gauge what impact the U.S. offer on sugar might have on securing enough votes for approval.

Sugar in WTO Negotiations. U.S. sugar policy may face change if negotiators reach a multilateral agreement that commits countries to proceed further in significantly liberalizing agricultural trade. For this reason, the U.S. sugar production sector and U.S. food and beverage manufacturers that use sugar are watching carefully to see whether the outcome of these negotiations protects and/or advances their respective economic interests.

Launched in late 2001, WTO member countries agreed that the negotiating objectives for agriculture in the Doha Development Round should be: (1) substantial reductions in trade-distorting domestic support, (2) the phase-out, with a view to total elimination, of all export subsidies, and (3) substantial improvements in market access (i.e., reductions in tariffs and expansion of quotas). In August 2004, negotiators agreed upon a "framework agreement" to be followed to meet these objectives. In advance of the December 2005 Hong Kong ministerial conference, the United States, the EU, and two other country groups presented various agriculture "modalities" proposals (formulas, schedules, end dates) to add specifics to this framework. Negotiators, though, were not able to finalize a modalities package, and, working against a deadline of April 30, 2006, have not been able to complete this step.[2] In Hong Kong, those interest groups with a stake in U.S. sugar policy closely monitored the "market access" negotiations. Of most interest were discussions on how much (expressed as a percentage of tariff lines) a country should be allowed to protect its sensitive agricultural commodities, particularly imports from the least developed countries (LDCs). The adopted ministerial declaration calls for "duty-free, quota-free" imports from LDCs for at least 97% of all of a country's products. For the United States, this would apply to sugar imported from these countries, unless U.S. negotiators decide to exempt sugar from this obligation (i.e., to place sugar in the 3% category). What duties and quotas would apply to imports of sensitive agricultural products (applicable to sugar imports) from all other countries — an issue not resolved in Hong King — could also affect U.S. sugar policy. The ASA expressed concern that the U.S. proposal "could dump up to 750,000 tons of unneeded foreign sugar on a chronically oversupplied U.S. market" but did not seek to discipline indirect sugar subsidies, and would allow developing countries "to escape reforms." Others, though, pointed out that "modalities" that are closer to the EU proposal would leave the U.S. sugar program unchanged. The SUA as a member of an agribusiness/commodity/farm group coalition called on other countries to match the U.S. proposal to reduce trade-distorting subsidies "with equally ambitious" tariff reductions and export competition commitments.

Sweetener Disputes with Mexico

Ongoing differences over the level of market access for Mexican sugar to the U.S. market, and over Mexican barriers on imports of U.S. high-fructose corn syrup (HFCS), remain outstanding. The impasse largely reflects divergent views held by the U.S. and Mexican governments of NAFTA's sugar provisions; Mexican government actions on behalf of its powerful sugar industry to force a change in the U.S. position and to protect its share of the Mexican sweetener market; each government's filing of trade dispute cases before NAFTA and WTO panels; and unsuccessful efforts by government and private industry negotiators on both sides to arrive at some compromise. With free trade in sugar between Mexico and the United States to begin in just over 1½ years (January 1, 2008), high-level Mexican and U.S. government representatives have stated that NAFTA will not be renegotiated. Recent decisions made by both governments to resume limited trade in both sweeteners for FY2006, though, might create some room for resuming discussions on how to address these longstanding differences.[3]

Mexico's Terms of Access to the U.S. Sugar Market. In FY2001, Mexico under NAFTA became eligible to ship much more sugar duty free to the U.S. market than allowed in earlier years. Each country's negotiators have differed, though, over just how much sugar Mexico can export to the United States. Their disagreement centered on which version of the NAFTA agreement should govern sugar trade. U.S. negotiators based their position on the sugar side letter (dated November 3, 1993) to the NAFTA agreement agreed

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[2] For additional information, see CRS Report RL33144, *WTO Doha Round: The Agricultural Negotiations*.

[3] Though Mexico reciprocated to establish a duty-free 250,000 MT TRQ for imports of U.S. HFCS when the United States on September 29, 2005, announced a NAFTA duty-free TRQ for an identical quantity of Mexican sugar imports, these actions apply only for FY2006.

to in last minute talks between the U.S. Trade Representative and his Mexican counterpart. The Clinton Administration's decision to seek this letter was realization that if the concerns of the U.S. sugar industry were not addressed, the House would not pass NAFTA. The side letter was included along with other NAFTA documents submitted to Congress with the implementing bill. Mexican negotiators based their position on the provisions found in the initial August 1992 NAFTA agreement and signed by each country's president in late 1992.

The side letter effectively placed a lower cap on duty-free imports of Mexican sugar allowed to enter the U.S. market than would have been the case under the original NAFTA agreement. The side letter accomplished this by (1) redefining the original formula (sugar production minus sugar consumption) for calculating the amount of sugar that one country could ship to the other duty free ("net production surplus") to also subtract Mexican consumption of HFCS, and (2) raising, but keeping level, the maximum amount (250,000 MT) that could enter duty free during the FY2001-FY2008 period. For FY2001 and FY2002, USTR following the side letter announced NAFTA sugar TRQs of 105,788 MT and 137,788 MT, respectively. However, Mexico argued that, under the original NAFTA text, it should have been able to ship its entire net sugar surplus (projected by Mexican officials at 550,000 MT in FY2002). For FY2003, FY2004, and FY2005, USTR did not announce a NAFTA sugar quota, because Mexico did not show a 'surplus' under the side letter's definition. For FY2006, record Mexican sugar output resulted in a 'surplus,' which USTR acknowledged by announcing the maximum NAFTA sugar TRQ of 250,000 MT.

Dispute over U.S. HFCS Exports to Mexico. Since HFCS can be substituted directly for sugar, growth in U.S. sales of HFCS primarily to Mexican soft drink makers since the late 1990s began to increasingly displace Mexican sugar consumption. Also, two new plants built in Mexico by U.S. firms began to manufacture this alternative sweetener from imports of U.S. corn, adding to available HFCS supply. Mexican sugar mills, seeing their surpluses mount and seeking an export outlet, sought to have the Mexican Congress invalidate the side letter, and persuaded the Mexican government to initiate a dispute case to clarify NAFTA's sugar provisions. In 1998, the Mexican government imposed high anti-dumping duties on imports of U.S.-produced HFCS, seeking to prevent further damage to its domestic sugar sector. Subsequent NAFTA and WTO dispute panels ruled that these duties were inconsistent with Mexico's trade commitments. Mexico complied with the final WTO ruling, and established in mid-2002 a new TRQ for HFCS imports from the United States equal to the FY2002 U.S. sugar TRQ for Mexico. The Mexican Congress also entered the dispute, passing budget legislation for 2002 to impose a 20% tax on soft drinks containing corn syrup but not sugar. Observers viewed this tax as an effort by the Mexican sugar industry to recapture their home market and to apply pressure on the United States to negotiate a comprehensive solution on all sweetener disputes. Mexico's President Fox unsuccessfully sought to reverse the tax, but it was renewed by Mexico's Congress in 2003, 2004, 2005, and 2006, which essentially eliminated much of the market for U.S. HFCS and U.S. corn exported to Mexico for processing into HFCS, and jeopardized the viability of the U.S.-owned operations that manufacture HFCS there. The Corn Refiners Association (CRA), representing U.S. companies that produce and export HFCS, estimates that Mexico's tax results in more than $900 million in lost HFCS sales each year, with additional losses related to their investments in Mexico.

Pressured by Members of Congress to respond to Mexico's tax and CRA to take a firmer stance on the issue of HFCS access to the Mexican market, the USTR on March 16, 2004, announced the United States had initiated a case with the WTO challenging Mexico's "discriminatory" imposition of this 20% sales tax and a related distribution tax on soft drinks and other beverages not sweetened with cane sugar. It argued that these taxes are "inconsistent with Mexico's obligations in the WTO to apply taxes on comparable domestic and imported products in a non-discriminatory manner." On October 7, 2005, the WTO dispute panel ruled in favor of the United States. Mexico notified the WTO on December 6, 2005, that it will appeal this ruling. The WTO on March 6, 2006, reaffirmed its earlier decision, finding that the tax was inconsistent with WTO trade rules, and called upon Mexico to bring its laws into compliance. Mexico apparently will do so, with a top USDA official on May 10, 2006, stating that Mexico has pledged to remove this tax effective January 1, 2007. The outcome of July's presidential and congressional elections, though, could change the nature of how Mexico ends this trade impediment next year.

Outlook. Successive bilateral government and private sector efforts to date to find a resolution to the U.S.-Mexican sweetener trade disputes have not succeeded. This is largely because the issues of Mexican sugar access to the U.S. market and of U.S. HFCS access to the Mexican market have become so intertwined. This also has highlighted the differences that exist between the U.S. sugar production sector and its effort to protect its share of the U.S. sugar market, and the U.S. corn/refining sector and its goal to take advantage of market access under NAFTA to export HFCS and corn to Mexico. A similar dynamic exists in Mexico. There, some soft drink manufacturers want to use HFCS as a cheaper sweetener while Mexican sugar mills seek to retain their dominant share of the Mexican sweetener market — unwilling to accept HFCS imports if no corresponding outlet exists to export a sugar surplus that would develop as HFCS displaces Mexican sugar use.

Last fall's U.S. decision to allow sugar to enter from Mexico in FY2006 was largely driven by the immediate need to boost U.S. sugar supplies. With Mexican sales of over-quota sugar (paying the low tariff that applies) expected to grow, it is not clear how both governments and private sugar processing groups might engage on these issues over the next 1½ years. One option is to let the clock tick until 2008, when the side letter dispute becomes irrelevant, all quotas and tariffs on sugar and HFCS trade disappear, and the USDA pledge made during DR-CAFTA congressional debate to protect the sugar program from excess sugar imports no longer holds.

Another is to renegotiate NAFTA's sugar provisions and address the issue of HFCS sales. This has been attempted by the private sector in each country (the American Sugar Alliance, the Mexican Sugar Chamber, and at first by the CRA). Meeting infrequently since October 2003 to translate a deal on "principles" into details of an agreement that they hope both governments could accept, they have not resolved key differences. These include (1) the mix of raw sugar and refined sugar allowed to enter the U.S. market; (2) how to handle over-quota sales of Mexican sugar; and (3) whether to extend any new agreement beyond 2008. The Corn Refiners Association dropped out as a participant in July 2004, preferring not to be bound by any prospective limit on HFCS sales to Mexico that equaled Mexico's sugar access to the United States, nor to reopen the issue of renegotiating NAFTA. Further, other U.S. commodity groups that have benefitted, or would benefit, from NAFTA's complete opening of the Mexican market may oppose any new sugar deal. Their concern is prompted by the possibility that Mexican farmers would then pressure their government to abrogate or renegotiate NAFTA's corn, dry bean, and dairy products market access provisions. To date, top officials in both governments have signaled that NAFTA will take full effect in 2008 as planned, and that no renegotiating will occur. crsphpgw