Order Code RL33541

CRS Report for Congress

Background on Sugar Policy Issues

Updated July 26, 2007

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Prepared for Members and Committees of Congress

Congressional Research Service

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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 by firms that process these crops into sugar. To accomplish this, the U.S. Department of Agriculture (USDA) makes loans available at mandated price levels to processors, limits the amount of sugar that processors can sell domestically, and restricts imports. In support of the program, sugar crop growers and processors stress the industry's importance in providing jobs and income in rural areas. Food and beverage firms that use sugar argue that U.S. sugar policy imposes costs on consumers, and has led some food manufacturers to move jobs overseas where sugar is cheaper.

In a major policy change, the 2002 farm bill reactivated sugar marketing allotments that limit the amount of domestically produced sugar that processors can sell. The level at which USDA sets the national sugar allotment quantity, in turn, has implications for sugar prices. Accordingly, sugar crop producers and processors on one side, and sugar users on the other, have sought to advance their interests by influencing the decisions that USDA makes on allotment and import quota levels.

The issue of additional sugar imports "crowding out" domestic production was divisive when Congress debated the Dominican Republic-Central American Free Trade Agreement (DR-CAFTA) in 2005. Since then, attention on sugar trade issues has turned to the potential impact of free trade in sugar and high-fructose corn syrup (HFCS) — a substitute and cheaper sweetener — between the United States and Mexico, which takes effect on January 1, 2008. Unrestricted sugar imports from Mexico are projected to result in budget outlays (estimated at $1.4 billion over 10 years) as U.S. processors default on price support loans. This outlook conflicts with the current objective that the program operate at no cost and has become a key issue in crafting sugar provisions for the 2007 farm bill.

The House Agriculture Committee-reported farm bill (H.R. 2419) would mandate a sugar-for-ethanol program intended to address any sugar surplus that arises as a result of imports. USDA would be required to purchase as much U.S.-produced sugar as necessary to maintain market prices above support levels. Purchased sugar would then be sold to bioenergy producers for processing into ethanol. The CCC would provide open-ended funding for this program. Other provisions would increase minimum guaranteed prices for raw cane and refined beet sugar by almost 3%, and tighten the rules that USDA must follow to implement marketing allotments and administer import quotas (i.e., remove discretionary authority). These provisions reflect recommendations made by sugar crop producers and processors.

Food and beverage manufacturers that use sugar oppose these provisions, arguing that they "would take a sugar program from bad to worse," would increase costs by $100 million annually to consumers, and would restrict the availability of sugar for food use in the domestic market. They have signaled their intent to offer amendments during House floor debate to strike some of the committee-reported provisions and/or to extend the current program. This report will be updated.

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Sugar Policy Issues

Recent Developments

On July 26, 2007, the House Rules Committee reported out a rule (H.Res. 574; H.Rept. 110-261) that will be followed in floor debate on the 2007 farm bill (H.R. 2419). One amendment that will be permitted to be offered would strike all of the House farm bill's sugar provisions (including the sugar-for-ethanol program) and extend current program authority through 2012.

On July 19, 2007, the House Agriculture Committee completed consideration of its farm bill. The sugar provisions (reflecting recommendations made by the domestic sugar producers and processors) call for increasing sugar price support levels by almost 3%, revising marketing allotment authority to guarantee the domestic sector a minimum 85% share of the U.S. marketplace, and mandating that surplus sugar be purchased for resale for processing into ethanol as one way to meet the program's no-cost objective. Sugar producers and processors support the measure, appreciative that current sugar policy was not "weakened." Domestic manufacturers of food and beverage products that use sugar, represented by the Sweetener Users Association (SUA), responded that the proposed program "would take the U.S. sugar program from bad to worse," increase costs to consumers, and result in sugar program costs of almost $2 billion during the farm bill's five years.

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. The last bill extends it up through the 2007 crop year (i.e., most of FY2008).

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 FY2006, domestic production filled 73% 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 FY2006 was 27%.

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 2006, the U.S. raw sugar domestic futures price averaged 22.1¢/lb., compared to the world raw sugar futures price of 15.5¢/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 between $400 million and $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.

Main Features of U.S. Sugar Policy

U.S. sugar policy uses three 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 further requires USDA to operate the sugar program on a "no-cost" basis (i.e., to 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 20.72¢ to 21.46¢/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 23.5¢ to 27.13¢/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

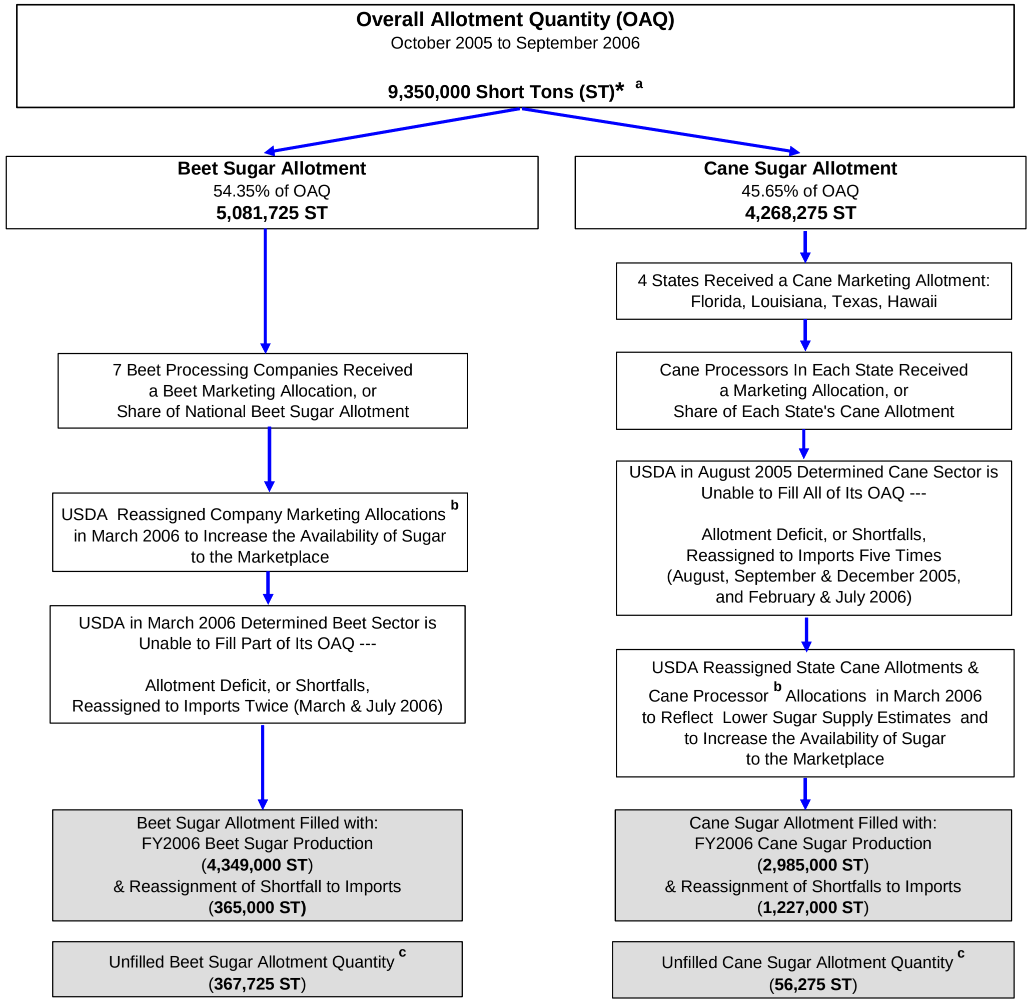
The 2002 addition of marketing allotments to support domestic sugar prices reflected the sugar production sector's willingness to accept reduced sales in return for the assurance of price protection. Allotments serve as a tool to ensure that any growth in U.S. sugar demand is first met by the U.S. sugar sector, and to guarantee both the beet and cane sectors a specific share of the U.S. market. By regulating the amount of sugar that processors can sell, USDA is expected to meet 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) beginning stocks, and (4) 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. Separate rules specify how each sector's allotment is to be allocated (i.e., distributed) to each processing 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 implemented marketing allotments for FY2006, the second year it activated some of the less-known features of this authority.

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, would 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 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.

Figure 1. Implementation of Sugar Marketing Allotments, FY2006



* One ST equals 2,000 lbs.

Notes: Reflects USDA decisions and U.S. sugar supply and demand status, as of August 11, 2006. Pending a formal USDA notice, the July 2006 announced shortfall of 246,000 ST is divided equally between the beet and cane sectors.

[a] OAQ includes two increases (September 2005 & February 2006) 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 to be marketed.

Source: Derived by CRS from USDA press releases and reports.

The USDA initial determination of the OAQ by August 1 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 — 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 significantly 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, and close to 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 five 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 and FY2007 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, which reduced domestic supplies. This decision allowed both the beet and cane sectors (unlike previous years) to sell all of their FY2006 sugar output against their allotment share of the OAQ. To meet the balance of U.S. sugar demand that could not be met from domestic sources, USDA reassigned the large cane sector's and small beet sector's "allotment shortfall" to imports (**Figure 1**). Earlier, on September 30, 2005, USDA announced the initial details of FY2006 marketing allocations for beet processing companies. Cane state allotments and processor allocations were announced later on March 22, 2006, after the company-specific impacts from the 2005 season's hurricanes had become clear.

On July 27, 2006, USDA set the **FY2007** OAQ at 8.75 million ST, reflecting its assessment of the upcoming year's sugar supply and demand outlook. Projecting that 2006/2007 U.S. sugar production and carry-in stocks would not be enough to meet domestic needs and rebuild ending stocks "to reasonable levels," USDA immediately announced a supply shortfall of 350,000 ST. This entire deficit was reassigned to imports (reflected in the related sugar import quota announcement) to help exporters facilitate shipping arrangements. USDA stated this was intended to ensure that sufficient sugar is available to the U.S. market earlier than would otherwise occur. USDA also signaled that "appropriate adjustments" to the OAQ would be made during FY2007 to ensure the domestic market is adequately supplied, to avoid loan forfeitures, and to prevent market disruptions.

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.[1] 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, and announced for FY2007). 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 and disputed 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 the DR-CAFTA TRQ, sugar can enter either in raw or refined form.

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 on above-quota sugar entering from Mexico under NAFTA (equivalent to about 7% in 2007) will fall to zero on January 1, 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 2.515 million ST, a level double 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 represented 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 the sugarcane crops in Louisiana and Florida, the hurricane-related closure of a large sugar cane refinery in New Orleans from late August to December 2005, and to make available high quality refined sugar for immediate use. On July 27, 2006, USDA announced that raw sugar under the FY2007 TRQ will be allowed to enter early (starting August 7) in order to meet refiners' needs for more flexibility in acquiring and processing raw sugar.

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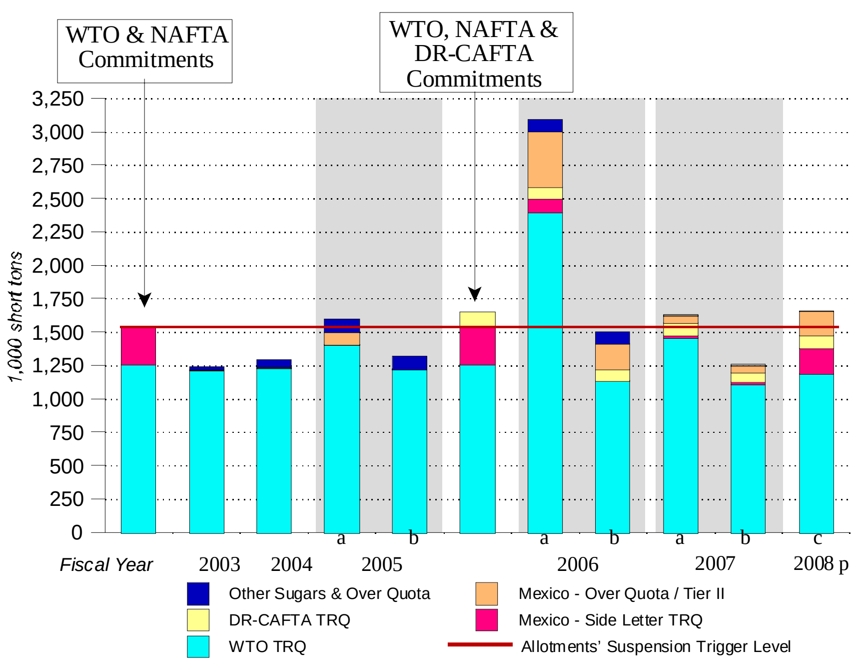
[1] A TRQ combines two policy instruments used to restrict imports: quotas and tariffs. The quota component works together with a specified tariff level to provide the desired degree of import protection. Imports entering under the quota portion of a TRQ are usually subject to a lower, or sometimes a 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.

FY2007 Import Quota Decisions. On July 27, 2006, USDA announced that the FY2007 raw and refined TRQs for sugar imports will be 1.544 million ST, 23% higher than the U.S. minimum WTO commitment. On that same day, USDA announced a NAFTA TRQ of 268,000 ST for Mexico, stating both countries had jointly determined that Mexico is projected to be a net 'surplus producer' of sugar in FY2007. The first announcement reflects USDA's assessment that imports above the WTO minimum commitment is needed to meet domestic needs and rebuild stocks. The second is part of a U.S.-Mexican agreement announced to resolve outstanding bilateral sweetener disputes (see "Sweetener Disputes with Mexico," below).

Sugar Imports, the Allotment Suspension Trigger Level, and DR-CAFTA. One concern raised during the congressional debate on DR-CAFTA was that the additional amount of sugar that enters, 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 agreement commitments would result in a sugar import level of 1.652 million ST (see **Figure 2**).

Figure 2. U.S. Sugar Imports Compared to Allotment Suspension Trigger: Trade Agreement Commitments; FY2003-FY2006 Actual; and FY2007-FY2008 Estimates



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

[a] Reflects TRQ announcements and USDA estimates. For FY2007, data are current as of June 7, 2007.
[b] Adjusted for USDA's formal reassignments of beet and cane allotment deficits to imports.
[c] For FY2008, USDA projection as of June 7, 2007. Mexico TRQ shown (added by CRS) reflects minimum amount agreed to in 2006 bilateral sweetener agreement. Projection subject to change.

Sugar imports in the first two years of current sugar program authority (FY2003 and FY2004) were well below the trigger level. With significantly lower domestic sugar supplies caused by weather-related problems in FY2005 and FY2006, permitted sugar imports were above this level. However, above average imports did not result in the suspension of allotments because USDA determined the additional imports were needed to meet U.S. sugar demand (see "Exception to Suspending Allotments," above). To explain further, USDA decided late in FY2005 to allow additional imports to add to domestic supplies tightened by the effects of Hurricane Katrina. This resulted in FY2005 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") did not count against the trigger level.

For FY2006, USDA projected lower sugar output and 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 under DR-CAFTA) equaled FY2006 sugar imports of 3.095 million ST — 1.563 million ST above the trigger level — but did not result in the suspension of allotments. Similarly, USDA currently projects FY2007 sugar imports at 1.634 million ST — 102,000 ST above the trigger level. Allotments again were not suspended because of the need for additional imports. For FY2008, USDA's import estimates plus the U.S. commitment to allow at least 193,000 ST of Mexican sugar to enter under a NAFTA TRQ could total 1.657 million ST — 125,000 ST above the trigger level (see **Figure 2**).

The issue of the potential impact of sugar imports on the U.S. sugar program under DR-CAFTA has receded for now, because USDA included these imports when setting the FY2006 and FY2007 OAQs. Looking ahead, whether sugar imports in FY2008 — the last year covered by current sugar program authority — activate the trigger to suspend allotments will depend on the extent to which domestic sugar production (particularly in the hurricane-affected cane sector) recovers, and the degree that U.S. commitments under existing trade agreements allow more sugar to enter than the U.S. sugar market can absorb and still allow USDA to administer the program at no-cost. 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, likely was made moot by a pledge made by the Secretary of Agriculture during congressional debate on DR-CAFTA. In a June 29, 2005, 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 Trade Issues — Sugar in DR-CAFTA — Sugar Deal to Secure Votes," below).

Legislative Activity in the 109th Congress

House Amendment to FY2007 Agriculture Appropriations. During floor debate on the FY2007 agriculture appropriations bill (H.R. 5384) on May 23, 2006, the House rejected (135-281) an amendment offered by Congressman

Blumenauer to effectively reduce the program's loan rates by about 6%, to not more than 17¢/lb. for raw cane sugar and 21.6¢/lb. for refined beet sugar. He argued that the sugar program artificially raises the price paid by consumers and food manufacturing firms, most of the program benefits go to large producers, and that it causes environmental damage in the Everglades. Opponents countered that the program does not cost taxpayers, is supported by two-thirds of those polled in a recent survey, and that any vote on a proposed program change should occur when the 2007 farm bill is debated. In June 2005, an identical amendment offered to the FY2006 agriculture appropriations bill (H.R. 2744) was rejected by the House on a vote of 146 ayes to 280 noes.

Senate Oversight Hearing. 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 USDA'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 the opening of 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 in his view 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 (i.e., the difference between the U.S. price and the lower world price).

Administration's FY2007 Budget Proposal. The Bush Administration's FY2007 budget proposal included legislative changes to reduce farm program spending, which included a 1.2% marketing assessment on domestic sugar processed by raw cane mills and sugar beet refiners. This would effectively have lowered loan rates by more than 0.2¢/lb, and generated receipts of an estimated $34 million in FY2007, and $364 million over 10 years. Congress did not address this specific proposal when each chamber passed its FY2007 budget resolution, and no additional legislative action occurred.

In 2005, the Administration proposed an identical marketing assessment in its FY2006 budget package. The Senate Agriculture Committee adopted a modified version, which was dropped by conferees when they completed action on the FY2006 budget reconciliation bill (S. 1932) in December 2005. The Senate-adopted provision 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.

Sugar Trade Issues

The United States imports sugar to cover the balance of its domestic food needs (16% in FY2005; 27% in FY2006) that are unmet by the U.S. sugar production sector. Sugar imported under market access commitments made by the United States in trade agreements (such as NAFTA) or under prospective free trade agreements (FTAs), together with the 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 noticeably.

The U.S. sugar production sector argues that liberalizing trade in sugar should be addressed in multilateral World Trade Organization negotiations, rather than 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 including sugar in all trade negotiations, eyeing the possibility that increased imports might contribute to program reform and lower sugar prices.

The sugar provisions in DR-CAFTA, strongly opposed by the U.S. sugar producing sector but favored by most other U.S. commodity groups, drew much attention during congressional debate. The debate drew attention again to NAFTA's sugar provisions. Free trade in sweeteners between Mexico and the United States will take effect in January 2008, after two longstanding trade disputes were resolved in July 2006. How to handle the prospect of unrestricted sugar imports from Mexico starting in 2008, added to sugar imports under other trade agreements, will be a major issue in the debate on the sugar program's future when Congress considers the 2007 farm bill.

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 has been more of an issue in negotiating bilateral and regional FTAs (witness the debate on DR-CAFTA) than in multilateral negotiations under the WTO. With Brazil, Colombia, Guatemala, and Thailand considered to be 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 mentioned that increased market access for its sugar in the U.S. market was one of their key agricultural priorities in the currently dormant 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 would begin to undermine the operation of the domestic sugar program as now structured (e.g., make it impossible for USDA to operate it at "no-cost"). By contrast, any multilateral agreement that might eventually emerge 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," below).

Key Interest Group Views. The American Sugar Alliance (ASA) representing sugar crop farmers and processors has argued 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, and the Mexican government's ownership of sugar mills) 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 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," below). 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), prior to its approval, were already allowed to sell to the United States a combined minimum of 311,700 MT of sugar annually under allocations, or shares, of the TRQ. This amount represented a 28% share of the minimum U.S. raw sugar TRQ (1.12 million MT) established under its WTO commitment, and entered 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, because of additional imports under DR-CAFTA, will be above the trigger level that would require 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.[2] 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 (CBO)). 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 an 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, Colombia, and Panama 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). Peru's 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. The American Sugar Alliance (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.

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[2] On July 10, 2006, USDA issued this report examining the economic feasibility of converting sugarcane, sugar beets, molasses, raw cane sugar, and refined sugar into ethanol. The study concluded that while such conversion would be profitable with current high demand for ethanol and record ethanol prices, it would be unprofitable when compared to ethanol prices projected for mid-2007. This report can be accessed at [http://www.usda.gov/oce/reports/energy/EthanolSugarFeasibilityReport3.pdf].

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. Panama, in the FTA concluded in mid-December 2006, received three small preferential TRQs for sugar and sugar-containing products allowed to be sold duty-free in the U.S. market. The largest duty-free TRQ (6,000 MT for raw sugar) will expand 1% annually for only 10 years and then be capped at 6,600 MT indefinitely; all over-quota tariffs on sugar product will remain at current high levels also indefinitely. All three preferential quotas represent a 23% increase over Panama's current minimum 2.7% share (30,540 MT) of the U.S. raw cane TRQ. The new quotas in the aggregate represent most of the sugar surplus that Panama traditionally has available to export each year. All three FTAs include a sugar compensation provision similar to that found in DR-CAFTA.

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. Trade ministers, though, were not able to finalize a modalities package, and subsequently failed to achieve a breakthrough at a crucial meeting of a core group of countries held in July 2006. Though negotiations were then "indefinitely suspended," WTO's director in late January 2007 declared that the process was now back "to full negotiating mode."[3] Efforts among four key trading countries, including the United States, to develop a compromise package to present to other countries to consider collapsed on June 21, 2007, putting into doubt the possibility of concluding a deal by the end of this year. WTO's director responded that a deal is still possible, and announced that talks will now shift back to Geneva to involve all of WTO's country members.

Interest groups with a stake in U.S. sugar policy have closely monitored the "market access" component of these negotiations. Of most significance is the issue of 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 American Sugar Alliance had expressed concern

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[3] For additional information, see CRS Report RL33144, *WTO Doha Round: The Agricultural Negotiations*, by Charles E. Hanrahan, Randy Schnepf.

that the U.S. October 2005 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 Sweetener Users Association as a member of an agribusiness/commodity/farm group coalition had called on other countries to match the U.S. proposal to reduce trade-distorting subsidies "with equally ambitious" tariff reductions and export competition commitments.

The ministerial declaration adopted in Hong Kong called for "duty-free, quota-free" imports from LDCs for at least 97% of all of a country's products. For the United States, this could 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). Also, what duties and quotas would apply to imports of sensitive agricultural products (i.e., applicable to sugar imports) from all other countries could also affect U.S. sugar policy.

Sweetener Disputes with Mexico

Longstanding 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), were resolved in a bilateral agreement reached by both governments in late July 2006. The terms of this agreement will apply until January 1, 2008, when bilateral free trade in sweeteners takes effect under NAFTA's original terms.[4] Until this breakthrough, the almost decade-long impasse had largely reflected 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 the sector's share of the Mexican sweetener market in light of increased imports of HFCS from the United States; each government's filing of trade dispute cases before NAFTA and WTO panels challenging the other's handling of these disputes; and unsuccessful efforts by government and private industry negotiators on both sides to arrive at some compromise. Resolution of both disputes appeared to be prompted by the U.S. government's recognition that sugar imports will be needed anyway to meet domestic sugar demand and rebuild stocks, in return for gaining access to Mexico's market for U.S. HFCS sales. Though the agreement in the short term settles the parameters of U.S.-Mexican sweetener trade, some observe that temporarily resolving the underlying problems has simply postponed dealing with them until 2008 and after. As a result, the development of the sugar title in the 2007 farm bill will involve exploring various options to address imports of Mexican sugar.

2006 Sweetener Agreement. In the July 27, 2006, exchange of letters between U.S. and Mexican agricultural trade negotiators, both governments agreed

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[4] A precedent for the outline of this agreement was set in the bilateral agreement announced on September 29, 2005, that applied only for FY2006. Then, the United States announced a NAFTA duty-free TRQ of 250,000 MT for sugar imports from Mexico. Mexico reciprocated by establishing a duty-free 250,000 MT TRQ for imports of U.S. HFCS.

on a number of measures "intended to promote an orderly transition to" free trade in sweeteners on January 1, 2008. In brief, the agreement provides for Mexican sugar access to the U.S. market equal to the amount of access that U.S. HFCS will have to Mexico's market during this period. Specific provisions call for:

- The United States to provide duty-free access for Mexican sugar as follows: 250,000 MT in FY2007, and from 175,000 to 250,000 MT in the first quarter of FY2008 (with the exact amount to be jointly determined by July 1, 2007, based on market conditions at that time).[5]

- Mexico to allow duty-free entry for an equivalent amount of U.S.-produced HFCS in FY2007 (250,000 MT), with the FY2008 quantity determined in the same way that the sugar TRQ amount is determined.[6]

- The United States to allow not less than 21,774 MT of Mexican refined sugar to enter duty-free by September 30, 2006 (i.e., reflecting USDA's objective to provide an adequate supply of high-

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[5] The 250,000 MT amount reflects U.S. implementation of the NAFTA sugar side letter, which the Clinton Administration negotiated with Mexico in November 1993 in order to secure enough votes for House approval of NAFTA. The Mexican government subsequently contested the validity of this side letter, which 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. Under the side letter's provisions, Mexico can ship not more than 250,000 MT of sugar duty-free to the U.S. market each year through FY2008, but only if Mexico shows a "net production surplus" (defined as Mexican sugar production, minus Mexican sugar consumption, minus Mexican HFCS consumption). NAFTA committed both countries to allow sugar to enter free (not subject to a tariff nor any quota restriction) from the other in 2008.

[6] Under NAFTA, Mexico committed to reduce its base tariff on HFCS imports (15%) from the United States to zero within 10 years (i.e., 2003). As HFCS sales to Mexico's soft drink sector began to displace bottlers' use of Mexican-produced sugar and Mexico's sugar sector sought to renegotiate NAFTA's sugar provisions, the Mexican government responded in 1998 by imposing high anti-dumping (AD) duties on U.S. HFCS imports. With the AD duties, U.S. HFCS sales leveled off but continued. Subsequent NAFTA and WTO dispute panels ruled that these duties were not consistent with Mexico's trade commitments. To comply with the WTO's final ruling, Mexico created in May 2002 a new TRQ for U.S. HFCS equal to the NAFTA sugar TRQ (under the sugar side letter's provisions) that the United States had announced for Mexico for FY2002. This policy also subjected over-quota HFCS imports to a prohibitive 156% or 210% tariff. Concurrently, Mexico's Congress imposed a 20% "soda tax" in 2002 — applied to soft drinks sweetened with corn syrup but not sugar. Both actions eliminated the Mexican soft drink sector's demand for HFCS, and resulted in negligible U.S. HFCS exports in the 2002-2005 period. In a subsequent case filed by the United States arguing that the tax was discriminatory in its application, the WTO accepted the U.S. position. In its final decision issued in March 2006, the WTO found the tax inconsistent with WTO trade rules and called upon Mexico to bring its laws into compliance. Mexico agreed to eliminate this tax, which its Congress did in December 2006, as part of this sweetener agreement.

quality refined sugar to users before the 2006 domestic crops are available for processing).[7]

- Mexico to meet its NAFTA commitment to allow duty-free entry of not less than 7,258 MT of sugar or syrup goods from the United States in each of FY2005, FY2006, and the first quarter of FY2008 (i.e., totaling 21,774 MT).

- The United States to eliminate its over-quota tariffs on imports of sugar from Mexico, and Mexico to eliminate its over-quota tariffs on imports of HFCS from the United States, effective January 1, 2008.[8]

- Only through December 31, 2007, Mexico to apply import licensing procedures on the permitted in-quota amounts of HFCS imports, and to develop and apply "bilaterally agreed" import licensing procedures on the specified amount of in-quota sugar imports, from the United States.

- Each country not to take any discriminatory action (e.g., imposing a tax or any other internal measure) to limit imports of the sensitive sweetener product from the other (for Mexico, HFCS; for the United States, sugar).

- Both countries to continue to consult and work to resolve other ongoing disputes involving trade in sweeteners, in order to facilitate the transition to free trade on January 1, 2008.

- Both countries to establish a joint industry/government task force to (1) help both governments prepare for the elimination of tariffs on sweeteners in January 2008 and (2) periodically review product shipments against this agreement's TRQs to ensure that they are promptly and fully utilized.

The letter exchange also confirms a separate bilateral agreement reached earlier and submitted to the WTO stating that Mexico will eliminate its "soda tax" no later than January 31, 2007.

Reactions to Agreement. The American Sugar Alliance expressed concern that this agreement "will not accomplish" the objective of an "orderly transition" to bilateral free trade in 2008 for U.S. sugar producers "under current market

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[7] This represents Mexico's share of the additional FY2006 refined sugar TRQ of almost 91,000 ST, announced by USDA on July 27, 2006. This allocation to Mexico reflects U.S. trade commitments under the WTO.

[8] The U.S. over-quota tariff on raw sugar from Mexico under NAFTA is 1.56¢/lb. (equivalent to an *ad valorem* duty of about 7%) in 2007, and will fall to zero in 2008. Mexico will continue to apply its MFN over-quota tariff on U.S. HFCS products in the interim — ranging from 156% to 210%, depending upon the sweetness intensity, not NAFTA's zero rate as initially set.

conditions." Its letter to Administration officials stated that the amount of Mexican sugar to be imported, together with sugar that will enter from other countries, "will oversupply and disrupt the U.S. sugar market." Particularly noted were the fall in the raw cane sugar futures price immediately after the July 27 announcement and a "more likely surge" in over-quota imports from Mexico in 2007 as the NAFTA tariff is further reduced. ASA also asserted that the agreement "abandons the fundamental principles that have governed NAFTA sweetener trade." It pointed out that USDA's estimates of deficits in Mexican sugar and HFCS supply and demand in FY2006 and FY2007 cannot be reconciled with USDA's determination that Mexico is a "net surplus producer" and granted access to the U.S. market, under the NAFTA side letter formula. The Corn Refiners Association welcomed the agreement, viewing its HFCS provisions as setting into "motion an irreversible path to free trade in January 2008, as the NAFTA intended." Acknowledging that it does not resolve all outstanding issues or compensate U.S. corn refiners for 10 years of losses, CRA stated that the agreement "solidifies the promise for increasing U.S.-owned corn sweetener presence in Mexico." The Sweetener Users Association commended USDA and USTR for a "successful resolution of these issues" and noted that in the long term, the agreement puts both countries "on a path toward an open North American sweetener market in 2008."

Potential Impact. The extent to which increased Mexican consumption of HFCS — a cheaper sweetener than sugar and primarily imported from the United States — displaces Mexican-produced sugar in that market will be the major factor influencing how much Mexican sugar is actually shipped to the U.S. market during the sweetener agreement period and beyond. Estimates vary on how much HFCS could displace the sugar consumed by Mexico's soft drink industry, which would be the primary user of HFCS under free trade. In 2004, the second year that the "soda tax" was in effect, Mexico's soft drink sector used a record 1.6 million MT of sugar — an amount that theoretically could all be displaced by HFCS over time. Analysts, though, estimate that HFCS could displace a sizeable, but smaller, portion of the sugar consumed by Mexico's soft drink sector (from 600,000 MT to 1 million MT).[9] The low end of this range reflects the view that a large portion of the soft drink bottlers that are owned by Mexican sugar processors will continue to use sugar rather than switch to HFCS. The high end assumes that Mexico's soft drink sector will substitute HFCS for sugar to the same extent as occurred in the U.S. soft drink sector.

Other factors will influence the quantity of sugar that Mexican processors could export to the U.S. market beginning in 2008. Some of these could reduce the level of actual shipments; a few factors could raise that level. Also, what transpires during the agreement's implementation period through year-end 2007 will affect the climate in which Congress considers the new sugar program. These factors include:

- how much more U.S.-produced HFCS is actually exported to Mexican soft drink bottlers. Though there currently is excess capacity in U.S. plants, the extent to which HFCS production is

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[9] Frank Jenkins, "World and US Sugar and Sweetener Market Outlook," presentation to ASA's 23rd International Sweetener Symposium, August 7, 2006, p. 18; *The Future of U.S. Sugar Policy*, prepared for ASA by McKeany-Flavell Company, Inc., June 14, 2006, p. 8.

increased to take advantage of regained access to the Mexican market will depend to some extent on whether firms find it more profitable to produce HFCS for export rather than produce ethanol to meet growing U.S. demand. With the high price of U.S. corn raising HFCS prices above historical levels, this alternative sweetener could become less competitive pricewise with Mexican sugar, and possibly reduce Mexican bottler demand for HFCS.

- how Mexican wholesale sugar prices compare to comparable U.S. raw sugar prices, and how Mexican sugar mills respond. If they are higher — the trend seen in much of the period since 2000 — Mexican mills may be more inclined to sell into their domestic market rather than export sugar to the U.S. market. Though historically high U.S. sugar prices in 2005/2006 encouraged Mexican firms to export sugar to obtain a better price than in their home market, the U.S. price already is falling back toward its historical range. As the U.S. market returns to a more balanced supply and demand situation, this could reduce the incentive for Mexican sugar mills to export as much to the United States. However, if U.S. HFCS exports to Mexico increase substantially and contribute to a fall in Mexican sugar prices, Mexican mills would find selling sugar to the United States a more lucrative option, if U.S. sugar policy (and in turn, U.S. wholesale sugar prices) stays the same.

- the degree to which the Mexican government intervenes, directly or indirectly, in the marketplace to ensure adequate domestic supplies and reduce sugar price increases. The level of Mexican sugar production, while trending up, does vary from year to year. Since Mexican government policy is to have sugar mills hold in reserve sugar equal to at least three months of domestic consumption,[10] lower output in some years could reduce the amount available for export. For this reason, the government can require mills to obtain permits before they are allowed to export sugar. The government also does at times permit sugar imports to dampen price increases.

- how the Mexican government proceeds to handle a number of seemingly intractable problems in its sugar sector. The sector employs more than 2 million workers, many producing and cutting sugarcane on very small plots, and is a powerful political force in the countryside. In 2005, Mexico's Supreme Court reversed the government's expropriation of about half of the country's sugar mills in 2001. The question that arises is what will happen to many of these operations. Will the government step in to inject financial support or let them fail, or will their private owners be able to return them to profitability? Various initiatives to diversify the sugar

[10] USDA, Foreign Agricultural Service, "Mexico Sugar Semi-Annual Report 2005," September 23, 2005, p. 6.

industry are being explored, with much attention focused on developing an ethanol industry that uses sugarcane as a feedstock. Relatedly, uncertainty remains over the legal status of a 2005 law to reintroduce government involvement in the Mexican sugar producing sector — opposed by the government and sugar mills, but supported by sugarcane associations and their political allies in Congress. Ultimately, the outcome of the debate over whether to introduce more market-oriented policies or to maintain the policy status quo will determine whether Mexico's sugar sector contracts to primarily meet domestic demand, or survives to likely generate a surplus of sugar that will seek an outlet in the U.S. market.

- whether Mexican sugar mills invest in processing equipment to improve the quality of sugar sold to U.S. sugar users. Reports indicate that shipments of Mexican "refined" sugar during FY2006 did not meet the standard that U.S. food manufacturers are accustomed to procuring and/or contained foreign material. This required U.S. importers to further process the sugar to remove impurities, or for example, to remove metal shavings. With the additional costs involved, U.S. sugar users may be less willing in a less turbulent market environment to purchase Mexican refined sugar, unless its quality improves.

2007 Farm Bill Debate on the Sugar Program

Sugar Program Options

In 2007, Congress will consider legislation to replace the expiring 2002 farm bill provisions for farm commodity price and income support programs, including those for sugar. In advance of this, interest groups with a direct stake in future U.S. sugar policy laid out their positions. In addition, others have floated a number of other policy options that might receive consideration. Taken together, these proposals include (1) extending the current program (i.e., keep the loan program with present price support levels, together with marketing allotment authority); (2) eliminating the current domestic program, but retaining authority to impose import quotas reflecting U.S. trade agreement commitments; (3) reducing current sugar price support levels, but retaining the loan features of the current program and repealing all marketing allotment authorities; (4) replacing the existing program with a market-oriented approach used for such program crops as grains, cotton, and oilseeds (e.g., direct payments, counter-cyclical payments, marketing loan gains — with benefits determined relative to specified loan rates and to-be-determined target prices); (5) authorizing a buyout of sugar marketing allotments (possibly similar to the quota buyout packages authorized for peanuts in 2002 and tobacco in 2004); (6) adopting a revenue insurance approach for all producers that bases government payments on producer revenue losses rather than on low commodity prices; and (7) making direct payments to sugar crop producers based upon historical acreage levels, among other possible options and variations. Converting sugar into ethanol is also expected to receive attention, in an expanded energy title in the farm bill, as one way to address any sugar surplus scenario and make the United States less reliant on foreign energy sources.

Factors That Will Affect the Debate. Key factors that will influence the debate are the likelihood of unrestricted sugar imports from Mexico once NAFTA takes full effect in 2008 and the funding level that the Agriculture Committees secured for farm bill programs in the FY2008 budget resolution.

Interest Group Positions. The **American Sugar Alliance** advocates an extension of the current "no-cost" sugar program, arguing that the status quo is the best way to preserve a viable U.S. sugar industry. ASA expressly opposes converting the sugar program into the type now used to support program crops, where USDA makes payments to producers when prices fall below specified levels. ASA emphasizes such a change would be "costly" and "unworkable" for the U.S. sugar producing sector, projecting a cost of $1.3 billion annually.[11] ASA further argues that problems would arise in implementing this type of program because the sugar industry is structured differently than other commodities, large sugar producers would quickly hit current payment limits on farm subsidies, bankruptcies and consolidations in the U.S. sugar sector could occur, and a costly program would be politically difficult to approve and maintain in light of the current federal budget outlook. Given a fixed or smaller budget for farm programs, sugar producers state that other commodity producers would not want to reduce their subsidies to make room for a subsidy program for the sugar producing sector.

Separately, recognizing that sugar imports from Mexico are inevitable under NAFTA, ASA wants sweetener trade with Mexico to be managed once free trade takes effect in 2008 so that the current U.S. sugar program can continue. This would mean that Mexico would control the quantity of sugar its sugar mills are allowed to sell (e.g., by operating a program similar to the U.S. sugar marketing allotment program) or agree to export its excess sugar to other countries besides the United States. A Mexican sugar company executive responded that marketing allotments would be "very unpopular" at this time with Mexican sugar processors, who would view such a move as an effort to limit their access to the U.S. market just as NAFTA's sugar provisions take full effect.[12]

In issuing its 2007 farm bill proposals on April 23, 2007, the **American Farm Bureau Federation** expressed its support for the continuation of the current sugar

[11] ASA released its assessment in mid-2006 to counter discussion of the policy option to change the current "no-cost" sugar program to a "standard" payment program. The study also concluded that this approach would cause "a dramatic drop in [sugar] producer price and income," and not benefit consumers with lower sugar prices since "food manufacturers historically have not passed savings from lower input costs" on to them. This study, cited in footnote 9, can be viewed at [http://www.sugaralliance.org/library/resourcedocs/MF-SugarPolicy-Final.pdf]. In response, the Sweetener Users Association issued an analysis critical of the ASA-commissioned study, available at [http://www.sweetenerusers.org/Cover%20Letter%20and%20The%20Future%20of%20U.S.%20Sugar%20Policy1.pdf].

[12] *Inside U.S. Trade*, "U.S., Mexico Sugar Producers At Odds Over Integrating NAFTA Market," August 11, 2006.

production and marketing program. Earlier, at its annual meeting held in early March, the **National Farmers Union** (another general farm organization) called for continuing the current U.S. sugar program.

The **Sweetener Users Association** is calling for changes to the current sugar program, in order to respond to external pressures (primarily increased sugar imports from Mexico) and "to achieve a more workable policy for the entire industry." Reflecting a shift in position from what it advocated in the 2002 farm bill debate, spokesmen emphasize that sugar users "need a steady, reliable supply of sugar and a healthy domestic production and processing sector" that is geographically dispersed enough to handle supply disruptions caused by hurricanes and quality problems associated with some imports. Initially, food manufacturers advocated that the sugar program needs to be reformed to meet this objective, and proposed that budget outlays for a different type of sugar program "can be acceptable and defensible if they help to make policies more market-oriented or help adjust to our trade commitments." A SUA spokesman stated that the existing program cannot be sustained anyway on a no-cost basis, pointing to estimates made by CBO which project that lower U.S. prices due to increased sugar imports from Mexico will result in loan forfeitures by sugar processors and accompanying USDA outlays. Recognizing that its call for a closer look at costly options to change the program would not be seriously considered by policymakers at this time, the SUA in mid-May 2007 instead proposed a scaled-back set of recommendations. It supports continuing the beet and raw cane sugar loan rates at current levels, but wants to impose a forfeiture penalty of about one cent per pound when a processor hands over sugar to USDA instead of paying off a price support loan. It also favors abolishing marketing allotments, recommends changes in how U.S. sugar quotas are administered, and calls for USDA to collect and report prices for raw and refined sugar.[13]

On April 23, 2007, a coalition of sweetener users and public interest, consumer, and taxpayer advocacy groups announced they had formed the **Sugar Policy Alliance** to seek reforms of the sugar program during 2007 farm bill debate.[14]

The **Corn Refiners Association** views sugar marketing allotments as "a barrier to sweetener trade with Mexico" because they cap sugar imports from Mexico at 250,000 MT and, in effect, do not allow U.S. HFCS sales to Mexico to increase above this level. CRA states it will not support the U.S. sugar program in the 2007 farm bill "if marketing allotments or any aspect of the sugar program jeopardizes full implementation of free trade in sweeteners under the NAFTA."[15]

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[13] Chicago Tribune, "U.S. sugar growers, users work on a deal," August 9, 2006; *Inside U.S. Trade*, "Sugar Producers, Users Remain At Odds Over Future of Program," August 18, 2006; and *The Dyergram*, "Users Unveil Farm Bill Proposal...," June 4, 2007, p. 1. For additional perspective on SUA's views, see "Congress Should Reform the U.S. Sugar Program," at [http://www.sweetenerusers.org/Congress%20Should%20Reform%20Sugar%20Program.pdf].

[14] [http://www.prnewswire.com/cgi-bin/stories.pl?ACCT=104&STORY=/www/story/04-23-2007/0004571442&EDATE=]

[15] CRA 2007 Farm Bill Position, August 2006, available at [http://www.corn.org/
(continued...)

USDA's Farm Bill Proposal. On January 31, 2007, the Secretary of Agriculture released its proposals for congressional consideration in this year's debate. For sugar, USDA proposes that the objectives of operating a no-cost program by managing supplies be continued with two changes. These are (1) the removal of the 1.532 million ton import trigger that automatically suspends allotments and (2) discretionary authority to administer these allotments to reduce the program's future cost exposure (estimated at $1.4 billion over 10 years). In response, the ASA stated that USDA's proposal is a "positive development" but expressed concerns over the discretionary authorities the Secretary would exercise. The SUA did not issue any public statement on USDA's proposal.

Status of Sugar in 2007 Farm Bill Debate to Date

On June 6, 2007, during markup of titles under its jurisdiction, the House Agriculture Subcommittee on Specialty Crops, Rural Development and Foreign Agriculture extended the current sugar program without change through 2012. Loan rates would not change; marketing allotments would continue to be applied as long as imports do not exceed 1.532 million tons. However, the full House Agriculture Committee expanded and revised these provisions in the chairman's mark issued on July 6.

As approved by the committee, the major features of the sugar program in H.R. 2419 would:

- increase loan rates by almost 3% (from 18¢/lb. to 18.5¢/lb. for raw cane sugar; from 22.9¢/lb. to 23.5¢/lb. for refined beet sugar),
- guarantee the domestic sugar producing sector a minimum 85% share of the U.S. sugar market (irrespective of import levels),[16]
- mandate that USDA sell sugar acquired as a result of loan forfeitures and surplus sugar purchased to maintain prices above loan forfeiture levels to bioenergy producers for processing into ethanol (a gasoline additive),
- prescribe USDA's implementation (i.e., limit its discretion) of sugar import quota authorities

The American Sugar Alliance has come out in support of the committee's bill. A coalition of food and beverage firms and trade associations, and public interest groups, oppose the new provisions, and plan to offer amendments to delete some of them during House floor debate. The Bush Administration opposes the increase in sugar loan rates and is concerned about language that would limit USDA's ability to administer import quotas. For more discussion on the House farm bill's sugar

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[15] (...continued)
CRAFarmBillTalkingPoints.doc].

[16] This would replace the current import trigger provision, which when activated, requires USDA to suspend marketing allotments. If retained, the suspension of USDA's ability to manage domestic sugar supplies would likely lead to considerable price uncertainty (from the sugar producing sector's perspective) and make it difficult, if not impossible, to operate the sugar program at no cost.

provisions and reactions, see CRS Report RL34103, *Sugar Policy and the 2007 Farm Bill*.

In other legislative activity, two introduced bills would repeal the sugar program and/or related authorities, and likely allow for sugar crop producers to take advantage of a new approach to handle farming risk. Section 106 of **H.R. 2720** would repeal current authorities for both the program and the sugar tariff-rate quota; Section 107 would require USDA to establish a recourse loan program for sugar, meaning that any loans taken out by processors would have to be repaid when due (i.e., they would no longer have the right to hand over, or forfeit, sugar, to USDA if the market price falls below the effective price support level). Section 1006 of **S. 1422** would repeal the sugar program, but would not establish a recourse loan program. Both bills appear to make sugar beet and sugarcane producers eligible to take advantage of proposed farmer-held risk management accounts that could be used to purchase crop insurance, cover income losses, or invest in other on-farm improvements.

The Senate Agriculture Committee plans to hold its markup of farm bill provisions in mid-September, with the prospect that floor debate on the sugar program will surface again in October.