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Sugar Policy Issues

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Sugar Policy Issues

SUMMARY

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

Debate on a new sugar program occurred against the backdrop of structural changes in the production sector and an oversupply situation that caused historically low prices. Processors exercised their right to forfeit loans, which led to the first program outlays since the mid-1980s. USDA acted to mitigate the effect of low prices and continues to dispose of its large acquired sugar inventory.

In the debate, growers and processors stressed the industry's importance in providing jobs and income in rural areas. Sugar users, some cane refiners, and their allies argued U.S. sugar policy costs consumers and results in lost jobs at food firms in urban areas. The sugar production sector proposal (incorporated in the 2002 farm bill – P.L. 107-171) called for resolving trade disputes, retaining current loan rate levels, and relying on domestic marketing controls to control supplies. Program opponents advocated various approaches to reduce the level of price support, and/or phase out the program by mid-decade. During debate, the House and Senate rejected the amendments offered by opponents.

The sugar program in the 2002 farm bill increases the effective price support level by 5-6% compared to that available over the last 6 years, gives USDA tools to operate the program at no cost, and reactivates a mechanism to limit the amount of domestically produced sugar that processors can sell in the U.S. market in order to meet import commitments negotiated under two trade agreements.

Congressional attention now turns to a provision in the Senate's trade bill that would establish a process for USDA to follow to reduce the entry of sugar into the U.S. market in forms intended to circumvent the sugar import quota. Sought by sugar producers and cane refiners, this amendment is opposed by importers of sugar-containing products. Both sides will seek to influence this amendment as the conference committee resolves differences between the House and Senate trade bills.

These same groups will also closely monitor how USDA implements the new program's authorities (especially the marketing allotment provisions), what steps USDA takes to reduce or eliminate the balance of its sugar inventory, and what sugar import quota decisions the U.S. Government announces for FY2003 to meet trade agreement obligations. The U.S. sugar and corn syrup producing sectors are monitoring and will seek to influence the direction of U.S. Government efforts to settle contentious sweetener disputes with Mexico. If and how these are resolved will affect U.S. sugar supply and price prospects.

Most Recent Developments

Sixty House members have called on House conferees appointed to resolve differences with the Senate on trade legislation (H.R. 3009) to reject a Senate provision intended to address the sugar production sector's and cane refiners' concerns that sugar is entering the U.S. market in ways that circumvent the existing structure of sugar import quotas (see ***Circumvention of Sugar Import Quotas****). Their position was stated in a letter to the chairman of the Ways and Means Committee, who will serve as the House chair in conference.*

Background and Analysis

Brief History of the Sugar Program

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

The United States has a long history of protection and support for its sugar industry. The Sugar Acts of 1934, 1937, and 1948 required the U.S. Department of Agriculture (USDA) to estimate domestic consumption and to divide this market for sugar by assigning quotas to U.S. growers and foreign countries, authorized payments to growers when needed as an incentive to limit production, and levied excise taxes on sugar processed and refined in the United States. This type of sugar program expired in 1974. Following a 7-year period of markets relatively open to foreign sugar imports, mandatory price support only in 1977 and 1978, and discretionary support in 1979, Congress included mandatory price support for sugar in the Agriculture and Food Act of 1981 and the Food Security Act of 1985. Subsequently, 1990 farm program, 1993 budget reconciliation, and 1996 farm program laws extended sugar program authority through the 2002 crop year. Even with price protection available to producers, the United States historically has not produced enough sugar to satisfy domestic demand and thus continues to be a net sugar importer.

Prior to the early 1980s, domestic sugar growers supplied roughly 55% of the U.S. sugar market. This share grew over the last 15 years, reflecting price protection provided by a sugar program. In FY2001, domestic production filled 88% of U.S. sugar demand for food and beverage use. As high-fructose corn syrup (HFCS) displaced sugar in the United States during the early 1980s, and domestic sugar production increased in the late 1980s, foreign suppliers absorbed the entire adjustment and saw their share of the U.S. market decline. The import share of the U.S. sugar market last year was 12%.

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

Sugar Policy in the 1996-2001 Period

Background

The 1996-enacted sugar program kept intact the broad outlines of prior U.S. sugar policy (with one change), but adopted two new features that were expected to inject some price uncertainty into the domestic sugar market under surplus supply conditions. Changes made by Section 156 of the Agricultural Market Transition Act of 1996 were intended to make the sugar production sector more responsive to market forces and were at that time accepted by sugar producers and processors as the political price for keeping the basic program intact. These program provisions still apply to sugar processed from the 2001 beet and cane crops. The new program (see **Sugar Program in the 2002 Farm Bill**) begins later this summer for the 2002 crops without the two provisions described immediately below.

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

Loan Forfeiture Penalty. The second change required USDA to impose about a 1 cent per pound penalty on any processor forfeiting sugar to the Commodity Credit Corporation (CCC). This applied only when sugar had been pledged as collateral for taking out a "non-recourse" loan. The CCC is the entity that finances USDA programs using funds borrowed from the U.S. Treasury. This provision effectively reduced the statutorily-set level of price support protection available to processors by one cent. With market prices for raw cane and refined beet sugar below loan forfeiture levels (see **Effective Price Support Levels** below for explanation) toward the end of FY2000 when non-recourse loans came due, processors forfeited just over 12% of 1999 domestic sugar output to the CCC that they had placed under loan earlier in the year. To exercise this right to forfeit on these loans (plus a small amount of loans that came due in FY2001), processors paid $13.5 million in forfeiture penalties to the CCC.

Policy Overview

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

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

Loan Rates. The 2002 farm bill freezes loan rates — 18¢ per pound for raw cane sugar and 22.9¢ per lb. for refined beet sugar — at levels first set in 1995 for another 6 years. Loan support for beet sugar is set higher than for raw sugar, largely reflecting its availability after processing as a product ready for immediate industrial food and beverage use or for human consumption (unlike raw cane sugar). By contrast, raw cane sugar must go through a second stage of processing at a cane refinery to be converted into white refined sugar that is equivalent to refined beet sugar in end use. Any processor that meets requirements can take out a non-recourse loan at these rates (adjusted by region and other factors).

Effective Price Support Levels. The above loan rates do not serve as the price floor for each type of sugar. In practice, under the new farm bill, USDA's aim will be to support the raw cane sugar price (depending upon the region) at not less than 20.1¢ to 21.2¢ per lb. (i.e., the price support level in a region *plus* an amount that covers a processor's cost of shipping raw cane sugar to a cane refinery *plus* the interest paid on any price support loan taken out plus location discounts). Similarly, USDA will seek to support the refined beet sugar price at not less than 23.0¢ to 25.9¢ per lb. (i.e., the regional loan rate *plus* specified marketing costs *plus* the interest paid on a price support loan), depending on the region.[1]

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[1] These ranges of effective price support levels reflect the new program's repeal of the loan forfeiture (continued...)

USDA aims to meet these "loan forfeiture," or higher "effective" price support, levels by (1) limiting the amount of foreign raw sugar imports allowed into the United States for human consumption, and soon under the new program by (2) limiting the amount of domestically-produced sugar permitted to be sold under the marketing allotment mechanism, and (3) offering sugar in its inventory to processors (and growers) who agree to reduce production. A loan forfeiture (turning over sugar pledged as loan collateral) may occur if a processor concludes, also weighing other factors, that the domestic market price at the end of the loan term is lower than the "effective" sugar price support level.

Import Quotas. USDA restricts the quantity of foreign sugar allowed to enter the United States for refining and sale for domestic food and beverage consumption to ensure that market prices do not fall below effective price support levels. The policy objective is to maintain market prices at not less than these levels to ensure that USDA does not acquire sugar due to a loan forfeiture.

Tariff-rate quotas (TRQs) are used as the policy instrument to restrict sugar imports to the extent needed to meet U.S. sugar program objectives. In practice, the U.S. market access commitment made under World Trade Organization (WTO) rules means that a minimum of 1.256 million ST of foreign sugar must be allowed to enter the domestic market each year. While the WTO commitment sets a minimum import level, policymakers may allow additional amounts of sugar to enter if needed to meet domestic demand. In addition, the United States committed to allow sugar to enter from Mexico under North American Free Trade Agreement (NAFTA) provisions. The complex terms are detailed in a schedule and a separate side letter, which lay out rules for calculating how much Mexico can sell to the U.S. market. Under the WTO and NAFTA agreements, foreign sugar enters under two TRQs — one for raw cane, another for a small quantity of refined (including specialty) sugar. The Office of the U.S. Trade Representative (USTR) is responsible for allocating these TRQs among 41 eligible countries, including Mexico and Canada. The amount entering under each quota (the "in-quota" portion) is subject to a zero or low duty. Sugar that enters in amounts above each quota is subject to a tariff that declines over time, according to the rate specified in each trade agreement. A prohibitive tariff on above-quota imports serves to protect the U.S. sugar producing sector from the entry of additional foreign sugar. In addition, other TRQs limit the import of three categories of sugar-containing products (certain products containing more than 10% sugar, other articles containing more than 65% sugar, and blended syrups). Quota and tariff provisions differ depending on whether these imports enter from Mexico, from Canada, or from any other country.

USDA on September 18, 2001, set the FY2002 tariff-rate quotas for sugar imports (raw and refined) at 1.421 million short tons (ST), raw value. This quantity is expected to account for some 14% of U.S. food consumption in FY2002. Of this amount, USDA allocated 151,855 ST to Mexico. This quantity reflects the U.S. position on the amount that Mexico is entitled to ship to the U.S. sugar market under NAFTA (see **Mexico's Access to the U.S. Sugar Market**).

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[1] (...continued)
penalty.

Program Costs and Receipts. The sugar program recorded $465 million in budget outlays in FY2000, the first significant direct costs of the program since FY1986. These reflected USDA's purchases of sugar and loan forfeitures made by processors, offset by forfeiture penalties paid by processors. In FY2001, program outlays totaled $31 million (half of which was associated with storing its sugar inventory). USDA estimates that it will recoup more than a third of its cost related to sugar purchases and forfeitures in FY2002. Earlier, during most of the decade (FY1991-99), the sugar production sector paid more to the CCC than it drew out. For the 1991-99 crops, sugar processors paid a budget deficit "marketing assessment" to the CCC on their sale of sugar produced from domestic cane and beet crops.[2] Imports were not subject to this levy. The $254 million in assessments collected during this period represented the sector's contribution to budget deficit reduction by generating revenues for the CCC.[3]

Sugar Industry, Market, and Program Developments

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

Congressional debate over sugar policy leading up to the 2002 farm bill changes took place against the backdrop of structural changes in the industry, historically low domestic sugar prices caused by oversupply, and the inability of policymakers working within the 1996-enacted U.S. sugar program framework to reconcile the two objectives of protecting the price of domestic sugar (under the sugar program) and also meeting trade agreement obligations that allow foreign sugar to enter the U.S. market (under the import quota).

Structural Changes

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

The decline in domestic sugar prices that began in fall 1999 contributed to the emergence of severe financial difficulties for firms operating facilities in the higher-cost sugar producing regions, and for the farmers who delivered crop to them. Two beet refining

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[2] In a policy change sought by the sugar production sector, Section 803(b) in the FY2000 agriculture appropriations measure (P.L. 106-78) effectively prohibited USDA from collecting this assessment in FY2000 and FY2001. This saved sugar processors an estimated $80 million over the 2-year period. The 2002 farm bill eliminated the sugar assessment, effective October 1, 2001.

[3] The peanut sector will pay a similar assessment only through the 2001 crop; authority to collect an assessment from the dairy and tobacco sectors expired in 1996 and 1998, respectively.

factories in California, and two raw cane mills (one in Hawaii, another in Louisiana), closed their doors over the last year. Others filed for bankruptcy or have actively sought buyers for unprofitable operations. Imperial Sugar Company (operating both beet and cane refining operations) came out of bankruptcy protection in August 2001. Part of its recovery plan included the sale of its four beet factories in Michigan to a farmer cooperative. Tate & Lyle (a British firm with multiple sugar and corn sweetener operations in North America) recently completed the sale of its Western Sugar Company operations in Colorado, Montana, Nebraska, and Wyoming to another farmer cooperative. Late in 2001, it completed the sale of its Domino Sugar cane refineries in New York City, Baltimore, and Louisiana to Flo-Sun, a Florida-based privately-held firm that harvests cane for processing in its 3 raw cane mills and 2 cane refineries.

Low Sugar Prices and USDA's Responses

In marketing year *1999/2000*, record domestic sugar production from the 1999 crops, combined with imports of sugar permitted under trade agreements or entering not subject to any limitation, contributed to a substantial oversupply. Since the U.S. government could not further reduce imports to accommodate higher domestic sugar output without breaking its market access commitment to other countries made under World Trade Organization rules, USDA intervened to bolster market prices that had fallen below effective price support levels. Government sugar purchases, and USDA's decision to pay growers sugar "in-kind" (PIK) to plow under some of their to-be-harvested crop in order to reduce output, though, did not raise prices enough to enable processors pay back all of their price support loans when they came due. Some processors exercised their right to "forfeit" 10% of FY2000 sugar output (1,090,320 ST), and USDA recorded significant program outlays ($465 million in FY2000).

During the *2000/01* marketing year, USDA reduced about one-third of its inventory under the first sugar PIK program. Lower raw cane sugar output helped prices to recover above loan forfeiture levels. Refined beet prices, though, did not rise above their forfeiture levels until late in September 2001, largely in response to a reduced production outlook, and USDA's policy to continue disposing of its sugar inventory in order to reduce storage costs and bolster market prices. It announced sales would occur whenever specified market price levels thresholds were reached, and that it would offer another sugar PIK program.

In the current *2001/02* marketing year, USDA has further reduced its inventory by completing its second PIK program, concluding several sales of refined beet sugar, and facilitating the exchange of some of its acquired raw cane sugar for what some foreign countries would have shipped to the U.S. market under their respective allocations of the U.S. sugar TRQ. These initiatives, excessive rainfall that may adversely affect the beet crop in the Red River Valley area, and expectations that marketing allotments will limit some sugar sales after October 1, 2002, have contributed to a firming in both raw cane and refined beet sugar prices. With prices currently above loan forfeiture levels, the earlier prospect that some sugar might be forfeited later this summer is fading.

Sugar Trade Issues

The United States must import sugar to cover the balance of its domestic needs that the domestic sugar producing sector cannot supply (currently about 12%). Therefore, provisions found in trade agreements specific to both imports and exports of sugar, sugar-containing products, and other sweeteners such as corn syrup affects the economic interests of the U.S. sugar production sector, domestic cane refiners, U.S. manufacturers of corn sweeteners, domestic sugar users, and sugar exporting countries. These provisions are complex, reflecting compromises in U.S. trade negotiations and the results of bilateral talks to resolve disputes, and the economic interests of all parties with a stake in U.S. sugar policy.

Trade in sweeteners affects the domestic sugar supply situation, and in turn, the level of U.S. sugar market prices. Sugar imported under market access commitments made by the United States in the NAFTA and WTO trade agreements, together with some sugar products that were not subject to import restrictions until recently, have added, or could under certain conditions contribute, to a U.S. sugar surplus and pressure prices downward. U.S.-Mexican efforts to reach an accommodation among sweetener industry sectors in both countries is probably the most important trade issue. The success or failure of ongoing talks will make this issue an even more important factor in how USDA administers the enacted 2002 program provisions. Economic interests with the most at stake are the: (1) the U.S. sugar production sector, concerned about the amount of sugar allowed to enter the domestic market under Mexico's access under NAFTA's terms; (2) U.S. manufacturers of high-fructose corn syrup (HFCS), seeking to take advantage of a market opportunity opened under NAFTA to sell to the large Mexican market; and (3) the financially ailing Mexican sugar sector, pressing to expand sales to the U.S. market, in large part because of its concern that domestic sales will increasingly be displaced by the Mexican soft drink industry's import of cheaper HFCS from U.S. corn wet millers. The importance and sensitivity of this matter are reflected in the fact that sweetener issues have been frequently discussed at meetings held by both countries' presidents since the late 1990s. Developments on two closely intertwined sweetener trade disputes will be closely watched to see if both can be resolved by September 2002, when each country faces deadlines on deciding upon key features of next year's sweetener policies.

Separately, an August 2001 court decision on the issue of "stuffed molasses" imports ruled in favor of the domestic sugar industry. Seeking to head off the prospect that other products could be used to circumvent the U.S. sugar import quota system has continued to receive congressional attention. The Senate's trade adjustment assistance bill (S. 1209), incorporated in the trade legislation passed by the Senate (Section 1002 of H.R. 3009), includes a precedent-setting provision to address the sugar industry's desire to establish a process to prevent such circumvention. A coalition of food groups that sell imported sugar-containing products strongly oppose this amendment.

Mexico's Tax and Trade Policies on Corn Syrup Imports from the United States

Legislation passed by the Mexican Congress on January 1, 2002, to tax soft drinks containing corn syrup but not sugar temporarily eliminated the market for U.S. corn and HFCS (processed from corn) in Mexico and jeopardized the viability of two U.S. companies that manufacture HFCS there. The U.S. corn and HFCS sectors viewed this as a step back in negotiating a resolution to the HFCS dispute, and pressed Administration officials to persuade Mexican authorities to remove this tax. Observers view the new soft drinks tax, though, as an effort by the Mexican sugar industry to capture back their home market and apply pressure on the United States to negotiate a comprehensive solution on all sweetener disputes sooner rather than later. Though Mexican President Fox in late March suspended the application of this tax through the end of September, the Mexican Congress on April 2 voted to challenge his decision in the country's Supreme Court. Reflecting this uncertainty, U.S. exports to Mexico of corn for processing into sweeteners and also HFCS remain at low levels. This issue is also tied to earlier WTO and NAFTA panel rulings that found Mexico's 1998 decision to impose anti-dumping duties on imports of U.S.-produced HFCS to prevent further damage to its domestic sugar sector was inconsistent with its trade commitments. To comply with these rulings, Mexico on April 22 established a new tariff rate quota for HFCS imports from the United States. Imports above the 148,000 metric tons (MT) quota will be subject to a 210% duty. Observers note that this quota equals the amount of Mexican sugar the U.S. government will allow to enter this year under NAFTA (see below) and WTO provisions. In followup action, Mexico completely lifted its high anti-dumping duties on imports of U.S. HFCS in mid May 2002.

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

Starting October 1, 2000, Mexico under NAFTA became eligible to ship much more sugar duty free to the U.S. market than the 25,000 MT allowed to enter in earlier years. U.S. and Mexican negotiators continue to disagree, however, over just how much sugar Mexico actually can export to the United States. Their disagreement centers on which version of the NAFTA agreement governs this issue. U.S. negotiators base their position on the sugar side letter (dated November 3, 1993) to the NAFTA agreement that was struck in last minute talks between U.S. Trade Representative and Mexico's Secretary of Commerce and Development. The side letter was included with other NAFTA agreement documents that President Clinton submitted to Congress together with the implementing legislation. Mexican negotiators instead base their position on the sugar provisions of the August 1992 NAFTA agreement and signed by each country's president in December that year.

The side letter effectively places a lower cap on duty-free imports of Mexican sugar into the U.S. market than the ceiling would have been under the original NAFTA agreement. The side letter accomplished this by: (1) redefining the original formula for "net production surplus" – the amount of sugar that one country could ship to the other duty free – to also add consumption of HFCS, and (2) raising, but keeping level, the maximum amount that could enter duty free during the FY2001-FY2007 period. Looking at FY2002, Mexico under the side letter's terms can export its "net surplus" but not more than 250,000 MT of sugar duty free. USDA announced on September 18, 2001, that Mexico under the side letter's formula can sell 137,788 MT of sugar to the United States in FY2002. Under the original NAFTA agreement, Mexico (if determined to be a net surplus producer under the original agreement's formula for two consecutive years) would have been able to ship its entire projected net sugar surplus. If this formula were used, Mexican officials argue that 550,000 MT would be eligible for entry in the current year. Some have even called for renegotiating all of NAFTA's sugar provisions as a way to resolve this dispute and address future concerns.

The U.S. sugar production sector is concerned that a decision not to abide by the side letter would result in a flood of additional Mexican sugar into an already well-supplied U.S.

market. U.S. cane refiners urge that Mexican shipments under any negotiated deal be in the form of raw rather than refined cane sugar, so as not to undercut U.S. refining capacity. U.S. manufacturers of HFCS have signaled they want their concern about access to the Mexican market addressed. Looking ahead, the U.S. sugar industry is most apprehensive about the impact of other NAFTA provisions as they take effect. These include substantial over-quota sugar imports from Mexico projected to occur starting in FY2004 (e.g., likely to be price competitive in the U.S. market should world sugar prices fall to historically low levels), and unlimited duty-free imports beginning in FY2008.

Circumvention of Sugar Import Quotas

The sugar production and cane refining sectors are seeking a legislative remedy so that U.S. firms will not be able to take advantage of tariff "loopholes" to import sugar outside of the current sugar and sugar-containing product TRQs. Such activity is sometimes referred to as "circumventing" the quota. This initiative is one of the three "pillars" the production sector is seeking in order to achieve a sugar policy that accomplishes their objective of achieving a supply-demand balance that protects their interests. Sugar producers, processors, and refiners argue, citing the "stuffed molasses" case as a prime example (see below), that imports of some sugar mixtures and products have undermined the domestic sugar industry by adding to the sugar surplus. During Senate Finance Committee markup of trade adjustment assistance legislation (S. 1209) on December 4, 2001, Members approved an amendment offered by Senator Breaux to authorize USDA to identify imports that are circumventing the TRQs on sugars, syrups, or sugar-containing products, and to require the President to include such-identified products in proclaiming revisions to these quota provisions. This provision is found in the trade legislation package (Section 1002 of H.R. 3009) passed by the Senate on May 23, 2002. There is no comparable provision in the trade bill package that the House on June 26 agreed to.

A coalition of food groups oppose Section 1002 as written, arguing that it represents "a direct attempt to close the borders to lawfully imported sugar containing products." It points out that the amendment is so broadly written that food products that contain sugar, such as gelatin or ice tea mix, could be placed under a TRQ, despite its stated intent to target only those products that "circumvent" TRQs. The coalition claims the wording fails to define "circumvention," gives USDA "no effective guidance" on how to identify products for reclassification in a TRQ, allows for no review by the President or the courts of USDA determinations, and undermines the Department of Treasury's role in administering tariff laws by creating an exception for sugar-containing products. This coalition further states that the amendment could violate U.S. trade agreements and invite foreign retaliation. A group of House members have laid out these same arguments, and asked that House trade bill conferees reject the Senate amendment in conference.

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

Analysts have attempted to determine how much sugar is included in imports of sugar-containing products (SCPs). Such estimates can be viewed as a crude proxy for the amount of domestically-produced sugar displaced by the sugar content in such imports (or the amount by which demand for U.S. sugar might increase, depending on how USDA were to administer this amendment). Estimates of the quantity of sugar found in SCPs that might be covered by the amendment range widely – from 50,000 to over 500,000 short tons. If these quantities were added to the sugar supplied by the domestic sugar sector and by other countries under the import quota, the sugar content in imported SCPs would have equaled from half of 1% to 5% of all sugar delivered for human consumption in 2001.

This initiative reflects the production sector's objective to codify into law a mechanism to address situations similar to the "stuffed molasses" case, which took the regulatory process and courts more than three years to resolve. Starting in the mid-1990s, controversy surrounded the import by a Michigan company (Heartland By-Products, Inc.) of a liquid sugar syrup (i.e., "stuffed molasses"). This product was created from sugar imported into Canada at the low world price primarily from Brazil, mixed with molasses and water, and then shipped duty free to the United States taking advantage of a specific tariff provision. Using special equipment, this firm extracted sugar from this syrup and reportedly shipped the remaining molasses back to Canada where the process started over again. Concerned that this industrial-grade sugar sold to U.S. food companies displaced sales of domestically produced beet sugar (an estimated 118,000 short tons in 1999/00 – equal to 1.2% of total domestic food use that year), U.S. beet and cane refiners sought a remedy to block its import. Refiners argued that stuffed molasses was imported deliberately to circumvent the sugar TRQ, by entering under a tariff line that did not subject it to quota restrictions and high tariffs.

Seeking to "close this loophole," these refiners since early 1998 sought relief from U.S. Customs and then the courts. This process culminated in a court decision issued August 30, 2001, when the U.S. Circuit Court of Appeals in Washington unanimously ruled in favor of the U.S. Government and the Beet Refiners' Association. Its decision upheld the Customs' 1999 ruling that imports of stuffed molasses should be subject to the sugar import TRQ's limits. In its decision, the 3-judge panel stated that the U.S. Court of International Trade (in countering Custom's ruling in a subsequent decision) went too far in determining that this product was not foreign in origin and thus not covered by the TRQ. The American Sugar Alliance representing growers and processors applauded the decision, stating it "cuts off one avenue for circumventing the sugar import rules."

Sugar Program in the 2002 Farm Bill

Overview

The 2002 farm bill includes a sugar program that slightly increases effective price support levels for raw cane sugar and refined beet sugar, and reactivates a mechanism (called "marketing allotments") to limit the amount of domestically produced sugar that can be sold when imports are projected below a specified level. Other provisions require the program to operate again at no-cost to the federal government, modify some features of the 1996-enacted program, explicitly authorize a payment-in-kind program for sugar, and prescribe in great detail how USDA must administer marketing allotments. Some provisions are designed to meet the sugar production sector's objective that the program operate at no cost.

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

New Sugar Program's Provisions

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

One provision took effect immediately upon enactment on May 13, 2002 – the repeal of the loan forfeiture penalty. Another change was made retroactive – the marketing assessment was eliminated effective October 1, 2001. Loan provision authorities will take effect starting in late August for refined beet sugar processed from the 2002 beet crop (i.e., loan provisions) and then later this year for raw cane sugar processed from the 2002 sugarcane crop. The marketing allotment and no cost provisions will apply beginning October 1, 2002. Other provisions, such as the storage loan program, will take effect when USDA issues implementing regulations.

Major provisions –

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

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

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

- ***repeal the loan forfeiture penalty*** effective May 13, 2002 (see page 2 for explanation).

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

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

- ***require marketing allotments[4] when imports are below 1.531 million short tons (ST)***. By limiting the amount of domestically-produced sugar that raw cane mills and beet refiners can sell, this mechanism ensures that the United States meets its annual market access commitments for sugar imports under the WTO agreement (1,255,747 ST) and under NAFTA's sugar side letter in effect through FY2007 (up to a maximum 275,578 ST). Provisions detail the formula that USDA must follow to calculate the amount of domestic sugar that can be sold (i.e., the total allotment), specify the factors to apply in making this determination, and split the allotment between the beet and cane sectors at 54.35% and 45.65%, respectively. Additional rules specify how the raw cane allotment is to be distributed among sugarcane producing states, and then among the mills in each state. Separate rules stipulate how the beet sugar allotment is to be allocated among processing companies (many of which operate across state lines). Once the detailed calculations are made, each firm will be able to sell only as much sugar as stated in the allotment notification received from USDA.[5] USDA is charged with

[4] The 1996 farm bill suspended sugar marketing allotment authority, which is found in "permanent" agricultural law (Agricultural Adjustment Act of 1938). Under the 1990 farm bill which reactivated and amended this permanent authority, USDA imposed allotments three times in the 1991-95 period.

[5] Responding to concerns that the marketing allotment provisions would apply immediately upon the farm bill's enactment to sugar processed from the 2001 crops and still being sold, conferees agreed to defer their effect until later this summer to give processors and buyers time to adjust to a changed marketing environment.

establishing allotments for cane and beet processors by October 1, 2002, for sugar sold in the 2002/03 marketing year.

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

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

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

Background on New Program

The 2002 farm bill's sugar provisions reflect the recommendations offered by the American Sugar Alliance (ASA) – representing sugar farmers and processors – in testimony presented to the House and Senate Agriculture Committees in the spring and early summer of 2001. The ASA has commended committee and floor actions taken that reinstate a U.S. sugar policy that "will ensure stable prices for farmers and consumers and operate at no cost to taxpayers." It views the "domestic inventory management tool" included in the farm bill as "restoring balance to the U.S. sugar market" when there is a surplus. Its spokesmen have acknowledged that the industry "is reluctant to face the prospect of limited marketings in some years," but that trade commitments under the WTO and NAFTA agreements require the United States to import as much as 1.5 million ST of sugar each year (about 15% of consumption), "whether we need that sugar or not." They add that growers and processors under marketing allotments will have the flexibility to plant as much crops and produce as much sugar, respectively, as they wish, but noted that processors who increase sugar output faster than the growth in U.S. demand "may have to postpone the sale of some sugar, and store that sugar at their expense until the market requires it."

Farm Bill Debate on Sugar Program

The nearly identical sugar programs reported by the House and Senate Agriculture Committees were challenged by program opponents during floor debate. In the House, Representatives Dan Miller and George Miller offered an amendment on October 4, 2001, to replace the Committee's proposed sugar program with an approach they argued would result in a sugar policy more oriented to market forces. They had earlier expressed disappointment that the Agriculture Committee "decided to ignore the failure of the U.S. sugar program," noting that the measure approved contains "no meaningful reform" and turns “the clock back on consumers, workers, taxpayers and the environment.” Their amendment proposed to retain the current program's non-recourse loan feature, reduce the current level of sugar price support by almost 6%, increase financial penalties on processors that hand over sugar to the CCC rather than repay any non-recourse loans taken out, and designate $300 million from the amendment's savings for conservation and stewardship programs (with a priority for efforts in the Everglades). Price support would be reduced by 1¢ per pound for raw cane sugar, and 1.2¢ per pound for refined beet sugar (to 17¢ / lb. and 21.6¢ / lb., respectively). Penalties that processors would pay to the CCC would double if they forfeit on their price support loans (increasing to 2¢ / lb. for raw cane sugar, and 2.14¢ for refined beet sugar). The House rejected this amendment on a 177 to 239 vote.

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

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

LEGISLATION

P.L. 107-76 (H.R. 2330)

Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, 2002. During floor debate on October 25, 2001, Senate by unanimous consent agreed to amendment #1988 offered on behalf of Senator Dorgan to delay the remittance of FY2002 assessments to the CCC for marketings of raw cane sugar and beet sugar until September 2, 2002 (Section 749 in conference report). Section 773 of the House-Senate conference agreement requires USDA to transfer 10,000 tons of refined sugar in CCC inventory to a beet sugar refiner in Minnesota to compensate producers for 2000-crop related losses. House and Senate agreed to conference report (H.Rept. 107-275) on November 13 and 15, respectively. Signed into law November 28, 2001.

P.L. 107-171 (H.R. 2646)
Farm Security and Rural Investment Act of 2002. Title I, Subtitle C, Chapter 2 amends the Agricultural Market Transition Act of 1996 to authorize a sugar program for the 2002-2007 sugar crops. House Agriculture Committee included slightly different provisions in its farm bill measure amended and passed by voice vote on July 27, 2001. H.Rept. 107-191, Part 1, filed August 2; Part II filed August 31. During floor debate on October 4, the House rejected (177-239) amendment #343 offered by Representative Dan Miller to extend the sugar program at reduced loan rates. Measure (as amended) passed House 291 - 120 on October 5, 2001. Senate passed its version of the farm bill with slightly different sugar provisions on February 13, 2002 (see entry for S. 1731 below). Conference report (H.Rept. 107-424) filed May 1. On May 2, House motion to recommit with instructions to conference committee failed 172 - 251. House later that day agreed (280 - 141) to conference report. Senate agreed (64 - 35) to conference report on May 8. Signed into law May 13, 2002.

H.R. 2081 / S. 1652 (Miller, Dan / Santorum)
Sugar Program Reform Act. H.R. 2081 introduced June 6, 2001; referred to Committee on Agriculture. S. 1652 introduced November 7, 2001; referred to the Committee on Agriculture, Nutrition, and Forestry.

H.R. 3009 (Crane)
Andean Trade Promotion and Drug Eradication Act (as passed House on November 16, 2001); Trade Act of 2002 (as passed by Senate on May 23, 2002). Section 1002 of Division A (Trade Adjustment Assistance) as passed by the Senate requires USDA to set up a procedure to identify and stop violators of the tariff-rate quotas on sugar, syrups, and related sugar-containing products. This language is identical to the text of the amendment offered on December 4, 2001 by Senator Breaux and adopted by voice vote by the Senate Finance Committee during markup of S. 1209 (see entry for S. 1209 below). Section 1002 (Sugar Policy) was included in S.Amdt. 3401 offered by Senators Baucus and Grassley on May 10, 2002 to H.R. 3009, which the Senate agreed to by voice vote on May 23. The Senate passed (66-30) its amended version of H.R. 3009 on May 23. House on June 26 adopted H.Res. 450 that effectively combined its earlier-passed measure with other trade bills (as amended) for the purpose of entering into conference with the Senate. House conferees appointed that same day.

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

S. 1209 (Bingaman)
Trade Adjustment Assistance for Workers, Farmers, Communities, and Firms Act of 2001. Introduced July 19, 2001; referred to Committee on Finance. During markup on December 4, 2001, Committee adopted by voice vote an amendment (inserted as Section

1002) offered by Senator Breaux to require USDA to set up a procedure to identify and stop violators of the tariff-rate quotas on sugar, syrups, and related sugar-containing products. Committee on a voice vote ordered bill to be reported with an amendment in the nature of a substitute favorably. Reported (S.Rept. 107-134) on February 4, 2002. See entry for H.R. 3009 above for current status.

S. 1571 (Lugar)

Farm and Ranch Equity Act of 2001. Section 122 (e) amends sugar program authority. Introduced October 18, 2001; referred to Committee on Agriculture, Nutrition, and Forestry. Offered as an amendment (S.Amdt. 2473) but rejected (70-30) during floor debate on S. 1731 on December 12.

S. 1731 (Harkin)

Agriculture, Conservation, and Rural Enhancement Act of 2001. The Agriculture Committee during markup on November 15, 2001, approved (12-9) a commodity title that includes a revamped sugar program. Committee filed S.Rept. 107-117 on December 7. During floor debate on December 12, Senate tabled (71-29) an amendment (S.Amdt. 2466) offered by Senator Gregg to phase out the sugar program and use any resulting savings to improve nutrition assistance. Senate approved in mid-February 2002 by voice vote two technical amendments (to modify process for allocating allotments to beet refiners (S.Amdt. 2836) offered by Senator Conrad; and to authorize USDA to increase the sugar import quota to make up for any shortfall in the amount of sugar countries supply to the U.S. market (S.Amdt. 2829) offered by Senator Feinstein). Senate passed S. 1731, as modified, on February 13, and incorporated it as an amendment to H.R. 2646 (see entry for bill above for final action).

S. 2323 (Graham)

Amends the Harmonized Tariff Schedule of the United States to require the tariff-rate quota covering specialty sugar imports to include a minimum quota for certified organic sugar. Introduced April 25, 2002; referred to Committee on Finance.