Order Code IB95117

Issue Brief for Congress
Received through the CRS Web

Sugar Policy Issues

Updated December 20, 2002

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Sugar Policy

SUMMARY

The sugar program is designed to protect the incomes of growers of sugarcane and sugar beets, and of 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, restricting sugar imports, and limiting the quantity of domestically-produced sugar that processors can sell (under the new marketing allotment authority).

Debate on the sugar program included in the 2002 farm bill 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 significant program outlays since the mid-1980s. USDA acted to mitigate the effect of low prices with purchases and a paid diversion program, and continues to dispose of its large acquired sugar inventory.

In farm bill 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 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. The House and Senate rejected opponents' amendments offered in debate.

The sugar program enacted in the 2002 farm bill (P.L. 107-171) increases the effective support level by 5-6% compared to that available over the previous 6 years, gives USDA tools to operate the program at no cost, and reactivates "marketing allotments" to limit the amount of domestically produced sugar that processors can sell in the U.S. market. This is intended to meet current import commitments accepted under two trade agreements.

In trade legislation, sugar producers and cane refiners sought to establish a mechanism for USDA to follow to reduce the entry of sugar into the U.S. market in forms intended to circumvent the sugar import quota. Importers of sugar-containing food products opposed a Senate-adopted provision. Conferees clarified that products containing molasses were to be made subject to a quota, but scaled back its scope to include Customs in the monitoring of such imports and to retain flexibility on handling any identified circumvention (Section 1002 of P.L. 107-210).

Sugar producers and users are monitoring USDA implementation of the new program's authorities (especially the marketing allotment provisions) and steps it takes to eliminate the balance of its sugar inventory. With mutual recognition that NAFTA sugar provisions have not worked, U.S.-Mexican negotiators have intensified efforts to resolve two long-standing sweetener trade disputes. Though both sides appear to have reached agreement on some matters, differences remain on the length of an agreement and how to handle over-quota Mexican sugar exports to the U.S. market. Separately, the U.S. sugar production sector argues that liberalizing trade in sugar should be addressed in multilateral negotiations but excluded from hemispheric and bilateral free trade agreements. Sugar users advocate including sugar in all trade negotiations the Bush Administration is pursuing.

Most Recent Developments

Eight senators and 12 House members on December 16, 2002, called for President Bush and Trade Representative Zoellick, respectively, to bring negotiations with Mexico on sweetener disputes to an immediate and successful conclusion. Their letters cited the financial harm that U.S. corn producers and the corn refining industry continue to experience, due to the lack of resolving disputed terms of access for Mexican sugar to the U.S. market and comparable terms for selling U.S. high-fructose corn syrup to Mexico. This request followed the Mexican Congress' decision to retain a tax on soft drinks sweetened with corn syrup in the 2003 budget, a stance that U.S. negotiators have stated they cannot accept as part of a prospective agreement.

Background and Analysis

Brief History of the Sugar Program

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

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

Prior to the early 1980s, domestic sugar growers supplied roughly 55% of the U.S. sugar market. This share grew over the last 15 years, reflecting the price protection provided by a sugar program. In 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.

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

Main Features of U.S. Sugar Policy

To support U.S. sugar prices, the USDA extends short-term loans to processors at statutorily-set price levels and limits imports of foreign sugar. The sugar program, though, differs from the grains, rice, and cotton programs in that USDA makes no income transfers or payments to beet and cane growers. In practice, overall U.S. sugar policy operates to indirectly support the incomes of domestic growers and sugar processors by limiting the amount of foreign sugar allowed to enter the domestic market. This is accomplished by using an import quota — a mechanism that is not an integral part of the sugar program's statutory authority as laid out in commodity legislation, but which operates as an integral part to ensure that market prices stay above effective support levels. Accordingly, USDA's decisions on the size of the import quota, and now under the newly-authorized program (see **Sugar Program in the 2002 Farm Bill** for details), on how it will administer sugar marketing allotments and other authorities, affects market prices. USDA administers these policy instruments to ensure that growers and processors realize the benefits of price support the law provides, whether or not loans are actually taken out.

Price Support

USDA extends price support loans to processors of sugarcane and sugar beets rather than directly to the farmers who harvest these crops. Growers receive USDA-set minimum payment levels (a requirement changed slightly by the 2002 farm bill) for deliveries made to processors who actually take out such loans during the marketing year — a legal requirement. With those processors that do not take out loans, growers negotiate contracts that detail delivery prices and other terms. These loans at times are attractive to sugar processors as a source of short-term credit at below-prime interest rates.

Loan Rates. The 2002 farm bill freezes loan rates — 18¢ per pound for raw cane sugar and 22.9¢ per lb. for refined beet sugar — at levels first set in 1995 for another 6 years (through the 2007 crop year). The loan support for beet sugar is set higher than for raw sugar, largely reflecting its availability after processing as a product ready for immediate industrial food and beverage use or for human consumption (unlike raw cane sugar). By contrast, raw cane sugar must go through a second stage of processing at a cane refinery to be converted into white refined sugar that is equivalent to refined beet sugar in terms of end use. Any beet or cane processor that meets statutory requirements can take out a non-recourse loan at these rates (adjusted by region and other factors). The loan's "non-recourse" feature means a processor can exercise the legal right to hand over sugar it initially offered USDA as collateral to fully repay the loan, if the market price is below the support level when the loan comes due.

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

Import Quotas

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

Tariff-rate quotas (TRQs) are used as the policy instrument to restrict sugar imports to the extent needed to meet U.S. sugar program objectives. In practice, the U.S. market access commitment made under World Trade Organization (WTO) rules means that a minimum of 1.256 million ST of foreign sugar must be allowed to enter the domestic market each year. Although the WTO commitment sets a minimum import level, policymakers may allow additional amounts of sugar to enter if needed to meet domestic demand. In addition, the United States committed to allow sugar to enter from Mexico under North American Free Trade Agreement (NAFTA) provisions. The complex terms are detailed in a schedule and a separate side letter, which lay out rules for calculating how much Mexico can sell to the U.S. market. Under the WTO and NAFTA agreements, foreign sugar enters under two TRQs — one for raw cane, another for a small quantity of refined (including specialty) sugar.

The Office of the U.S. Trade Representative (USTR) is responsible for allocating these TRQs among 41 eligible countries, including Mexico and Canada. The amount entering under each quota (the "in-quota" portion) is subject to a zero or low duty. Sugar that enters in amounts above the WTO quota is subject to a prohibitive tariff, which serves to protect the U.S. sugar- producing sector from the entry of additional foreign sugar. The tariff on above-quota sugar entering from Mexico under NAFTA continues to decline, and is viewed as a growing threat by the domestic production sector. In addition, other TRQs limit the import of three categories of sugar-containing products (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 July 30, 2002, set the FY2003 tariff-rate quotas for sugar imports (raw and refined) at 1.272 million short tons (ST), raw value. This amount is slightly higher than the U.S. commitment made under WTO rules, and just slightly above the quantity announced for FY2002. A sugar quota for Mexico under NAFTA provisions or under possibly new terms still being negotiated will be announced if, and when, both countries reach a resolution to their longstanding disputes on two sweetener issues (see **Sugar Trade Issues**).

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, four 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 beginning 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 factories in California, another beet factory in Nebraska, and two raw cane mills (one in Hawaii, another in Louisiana) closed their doors. Others filed for bankruptcy or 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 4 beet factories in Michigan to a farmer cooperative. In fall 2002, Imperial Sugar sold another 3 beet refineries (in Montana, Texas and Wyoming) to American Crystal Sugar Company (a cooperative based in the Red River Valley), and a beet factory in Wyoming to another cooperative. In November 2002, it announced it would close its Texas sugar refinery. Tate & Lyle (a British firm with multiple sugar and corn sweetener operations in North America) in mid-2001 sold its Western Sugar Company operations in Colorado, Montana, Nebraska, and Wyoming to another cooperative. Late in 2001, Tate & Lyle 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 WTO rules, USDA intervened to bolster market prices that had fallen below effective price support levels. Government sugar purchases, and USDA's decision to pay growers sugar "in-kind" to plow under some of their to-be-harvested crop in order to reduce output, though, did not raise prices enough to enable processors pay back all of their price support loans when they came due. Some processors exercised their right to "forfeit" 10% of FY2000 sugar output (1.1 million ST), and USDA recorded significant program outlays ($465 million in FY2000).

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

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

In the current **2002/2003** marketing year, sugar prices have strengthened considerably, reflecting the introduction of statutory marketing allotments that limit sales of domestic sugar and lower raw sugar output reflecting storm-related losses to Louisiana's sugarcane crop.

Sugar Program in the 2002 Farm Bill

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

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

To implement the new program for the 2002 sugar crops, USDA has issued revised program regulations (published in the August 26, 2002 *Federal Register*) to reflect farm bill changes. Other administrative announcements provide details on regional loan rates (issued September 27), the breakdown of 2002/03 marketing allotments between cane and beet (August 27), the allocations of these allotments among 5 cane producing states, all cane processors, and all beet refiners (October 1), and revisions to company-specific beet sugar allocations to reflect recent mergers (November 18). The most significant was USDA's determination of the national allotment quantity, the subject of a public hearing held September 4. The sugar production sector commented favorably on USDA's implementation of allotment-setting authority. Sugar users (primarily food manufacturing firms) disagreed, stating USDA set the allotments much lower than called for, when viewed against historical ending stock indicators.

New Sugar Program's Provisions

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

Major provisions (with some discussion on a few) –

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

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

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

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

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

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

- **require marketing allotments when imports are below 1.531 million short tons (ST)**. By limiting the amount of domestically-produced sugar that raw cane mills and beet refiners can sell, this mechanism ensures that the United States meets its annual market access commitments for sugar imports under the WTO agreement (1,255,747 ST) and under NAFTA's sugar side letter in effect through FY2007 (up to a maximum 275,578 ST). Provisions detail the formula that USDA must follow to calculate the amount of domestic sugar that can be sold (i.e., the 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 its allotment notification received from USDA.

  (USDA set the 2002/03 marketing year's overall allotment quantity at 7.7 million ST, just under 7% of the latest projected output. The raw cane sector will absorb much of the impact under this announcement, being required to hold off from selling more than three quarters of the estimated 555,000 ST of domestically-produced sugar determined to be in excess. Estimates show the cane sector will need to reduce its sales by almost 11% of projected production, compared to the 3% reduction that will apply to the beet sugar sector (see **Table 1**.))

Table 1. Comparison of Marketing Allotments to Projected Sugar Production, 2002/2003

	Statutory Share	Announced Allotments	Projected Production	Estimated Reduction in Sales	Reduction as Share of Production
	percent	*1,000 short tons, raw value*			*percent*
Refined Beet	54.35	4,185	4,315	130	3.0
Raw Cane	45.65	3,515	3,940	425	10.8
Total	100.00	7,700	8,255	605	6.7

Note: Allotments reflect USDA's August 27, 2002 announcement. Projected sugar production reflects USDA's December 10, 2002 supply estimate. Sugar sales reductions by sector are derived as the difference between production and allotments and will change during the year as USDA revises production estimates as cane and beet crops are processed into sugar. The amount of sugar required to be held off the market may also further change, to reflect quarterly USDA recalculations of the national allotment.

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

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

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

  (Final regulations reflect USDA's decision to apply the same interest rate on sugar non-recourse loans as it applies to loans extended to other commodities (2.5% for loans made in December 2002). The sugar production sector views this as contrary to the enacted provision; USDA's stance is the farm bill did not establish a specific sugar loan interest rate.)

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

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.

Sugar Trade Issues

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

Trade in sweeteners affects the domestic sugar supply situation, and in turn, the level of U.S. sugar market prices. Sugar imported under market access commitments made by the United States in the NAFTA and WTO trade agreements, together with some sugar products that were not subject to import restrictions until recently, have added, or could under certain conditions contribute, to a U.S. sugar surplus and pressure prices downward. At present, efforts to resolve U.S.-Mexican sweetener disputes are the most important sugar trade issue. The success or failure of continuing negotiations will be a key factor affecting USDA's implementation of the new sugar program's provisions. Economic interests with the most at stake are the: (1) the U.S. sugar production sector, concerned about the amount of sugar allowed to enter the domestic market under Mexico's access under NAFTA's terms; (2) U.S. manufacturers of high-fructose corn syrup (HFCS), seeking to take advantage of a market opportunity opened under NAFTA to sell to the large Mexican market; and (3) the financially ailing Mexican sugar sector, pressing to expand sales to the U.S. market, in large part until recently because of concern that its domestic sugar sales would increasingly be displaced by the Mexican soft drink industry's import of cheaper HFCS from U.S. corn sweetener firms. The importance of this matter are reflected in the fact that sweetener issues have been frequently discussed at meetings held by both countries' presidents since the late 1990s.

A provision in the trade promotion authority and adjustment assistance measure (Section 1002 of P.L. 107-210) addresses in part the domestic sugar industry's concern that some sugar-containing products are entering the U.S. market in a deliberate effort to circumvent the U.S. sugar import quota system. Separately, the sugar production sector advocates that the Bush Administration address further liberalization in sugar trade in the comprehensive multilateral WTO negotiations rather than in hemispheric and bilateral free trade negotiations involving major sugar exporting countries. Sugar users, though, argue that sugar should not be excluded from any prospective regional or bilateral trade agreement.

Sweetener Disputes with Mexico

Mexico's Tax and Trade Policies on Corn Syrup Imports from the United States. Legislation passed by the Mexican Congress on January 1, 2002, to 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 a long-standing HFCS dispute and have since 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 noticeably low levels.

The imposition of this tax is related to earlier WTO and NAFTA panel rulings that found Mexico's 1998 decision to impose anti-dumping duties on imports of U.S.-produced HFCS to prevent further damage to its domestic sugar sector was inconsistent with its trade commitments. To comply with them, Mexico on April 22, 2002, established a new tariff rate quota for HFCS imports from the United States. Imports above the 148,000 metric tons (MT) quota will be subject to a 210% duty. Observers note that this quota equals the amount of Mexican sugar the U.S. government allowed to enter in FY2003 under NAFTA (see below) and WTO provisions. In subsequent action, Mexico completely lifted its high anti-dumping duties on imports of U.S. HFCS in mid May 2002. Mexico's Supreme Court on July 12, 2002, ruled in favor of Congress' challenge and reinstated the 20% tax on soft drinks manufactured with HFCS. Mexico's Finance Ministry, in submitting its 2003 budget to Congress on November 5, proposed only to slightly alter the tax rather than eliminate it altogether as sought by the United States. In mid-December, the Mexican Congress decided to retain this tax in approving the 2003 budget, clouding prospects for a sweetener deal.

Mexico's Access to the U.S. Sugar Market. Starting October 1, 2000, Mexico under NAFTA became eligible to ship much more sugar duty free to the U.S. market than the 25,000 MT allowed to enter in earlier years. Until recently, U.S. and Mexican negotiators disagreed, however, over just how much sugar Mexico actually could export to the United States. Their disagreement centered on which version of the NAFTA agreement governed this issue. U.S. negotiators based their position on the sugar side letter (dated November 3, 1993) to the NAFTA agreement that was struck in last minute talks between U.S. Trade Representative and his Mexican counterpart. The side letter was included along with other NAFTA documents that President Clinton submitted to Congress together with the implementing legislation. Mexican negotiators instead based their position on the sugar provisions found in the August 1992 NAFTA agreement and signed by each country's president in December 1992.

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

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

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

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

Adding pressure to the negotiations are (1) calls by Mexican legislators that its government hold off complying with NAFTA provisions that eliminate quotas and tariffs on U.S. imports of potatoes, pork, poultry, among other products, effective January 1, 2003, (2) the prospect that if the United States applied the side letter's provisions in FY2003, Mexican access to the U.S. sugar market would be much smaller than FY2002's 148,000 MT, and (3) the adjournment of the Mexican Congress by the end of December. Since the Mexican Congress completed action on December 16 on the 2003 budget that retains the tax on HFCS-sweetened soft drinks, the prospect that an overall deal is soon reached appears to be fading. With signs that the Mexican sugar sector can live with the status quo, combined with U.S. corn producing and refining sectors' concerns about the growing economic fallout of no agreement, U.S. lawmakers on December 16 called on the Bush Administration to work toward an immediate conclusion to the negotiations.

Circumvention of Sugar Import Quotas

The sugar production and cane refining sectors have pursued a legislative remedy to prevent U.S. firms from taking advantage of tariff "loopholes" to import sugar outside of (to "circumvent") the existing sugar and sugar-containing product TRQs. This initiative is one of the three "pillars" the production sector has sought 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, citing the "stuffed molasses" case[1] as

[1] 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") from Canada. 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.

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a prime example, have argued 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 was included in the trade promotion authority and adjustment assistance legislative package (Section 1002 of H.R. 3009) passed by the Senate on May 23, 2002. There was no comparable provision in the trade bill package that the House on June 26 agreed to. House and Senate conferees subsequently reached agreement on July 26 on a compromise to the Senate provision. The conference report clarified that certain products containing molasses were to be made subject to a specific sugar TRQ, but pared back the scope of the Senate language to also include Customs in monitoring such imports and to retain flexibility for the executive branch and Congress on how any identified circumvention is to be handled (Section 1002 of P.L. 107-210). The compromise language, depending on how implemented, initially may serve to stop the flow of easily identifiable "stuffed molasses"-like products. Most observers, though, do not view it as sweeping in scope compared to the language initially introduced.

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

The sugar industry argued the Senate provision would enhance the function that TRQs perform in U.S. sugar policy by establishing a process to protect the industry from the impact of products containing sugar being imported into the United States in forms that have no commercial use. *Inside U.S. Trade* reported that one industry source stated the language "does not cover any finished products or any products with any commercial use in the form in which it is imported." The food group coalition, though, countered that the wording

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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." The U.S. Supreme Court on October 7, 2002, denied a petition filed by Heartland to hear an appeal of the August 2001 Circuit Court of Appeals ruling.

would require USDA to identify imports of manufactured food products found in four chapters of the Harmonized Tariff Schedule as circumventing the sugar and related product TRQs. The sugar industry claimed the provision would protect the market access of those countries with a share of the U.S. sugar TRQ by ensuring that their sales of sugar do not decline as a result of sugar-containing products entering intentionally to circumvent the TRQ.

Sugar in Negotiations on Future Trade Agreements

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

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

This assumes the U.S. domestic price remains significantly higher than the world sugar price, with this difference (or price premium) serving as the incentive for exporters to sell to the U.S. market rather than to the rest of the world. By contrast, any multilateral agreement that emerges from the WTO's Doha Development Round will reduce to some extent those trade-distorting policies used by countries to support their sugar and other commodity sectors. The degree to which such reductions might occur will not begin to become apparent until March 2003, when negotiators must settle upon the parameters and process that each country must use to develop specific reductions in trade distorting policies to arrive at a broad multilateral agreement by late 2004. Though still early to call, the final text and accompanying schedules that emerge are not expected to require the complete phasing out of such policies in all countries' sugar sectors, and thus would affect the U.S. sugar sector likely only at the margin.

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

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