

U.S. Department of Agriculture
Washington, D.C.
March 12, 2003

***“Implementation of U.S. Sugar Policy:
Views of the U.S. Sugar Producing Industry”***

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Introduction

Thank you, Mr. Secretary, for the opportunity to comment on USDA’s implementation of U.S. sugar policy. I am honored today to speak on behalf of the U.S. sugar-producing industry. I’m Jack Roney, Director of Economics and Policy Analysis for the American Sugar Alliance. The ASA is the national coalition of growers, processors, and refiners of sugarbeets, sugarcane, and corn for sweetener.

The United States Congress approved the sugar title of the 2002 Farm Bill by overwhelming margins. The House, in October 2001, by 58% of the votes cast, and the Senate, in December 2001, by 71% of all Senators, rejected amendments to dilute the sugar provisions of the Bill. Both chambers passed the omnibus Farm Bill by wide margins in 2002. The magnitude of Congressional support for U.S. sugar policy has been growing for some time (*Chart 1*).

Though it was given little time to do so, the U.S. Department of Agriculture has done an outstanding job of implementing the 2002 Farm Bill, including the sugar provisions. We commend the Administration for adhering to the will of the Congress on sugar policy.

We deeply appreciate, Secretary Penn, your attention to sugar policy and your steady hand in administering that policy in a manner that is fair to farmers, consumers, and taxpayers. We applaud the hard work and dedication of USDA analysts, particularly those in the Farm Service Agency, who have worked long hours to ensure that the policy is implemented efficiently and fairly. Their efforts have been successful, and American sugar farmers thank them.

I would like to provide a few thoughts on USDA's implementation of sugar policy thus far, and on the challenges the Department faces in its ability to continue to administer a successful, fair, no-cost U.S. sugar policy.

Supply Management in the 2002 Farm Bill

The 2002 Farm Bill mandates no-cost operation of a non-recourse loan program, by avoiding sugar loan forfeitures. Congress provided the Secretary of Agriculture with two tools to balance supply and demand and maintain prices above forfeiture levels: 1) the ability to control imports of foreign sugar, through the WTO-compliant tariff-rate quota (TRQ) program; 2) the ability to control domestic sugar sales through the restoration of the marketing allotments authority, which had been suspended in the 1996 Farm Bill.

Sugar is the only remaining program crop to retain supply management provisions in the 2002 Farm Bill. Sugar is also the only major program crop to be run at no cost to taxpayers, and to take no government payments, while government payments to other crop producers have escalated in recent years (*Chart 2*). Sugar farmers are also the only program-crop farmers who are required to reserve a large share (~15%) of their domestic market for mandated imports of foreign sugar, who earn all their returns from the marketplace, and who are required to store surpluses at their own expense to stabilize the market.

Recent Market Behavior. The absence of marketing allotments led to a price disaster for the U.S. sugar industry during 1999-2001. WTO and NAFTA import commitments prevented the Secretary from reducing the TRQ enough to compensate for unusually large crops in 1999 and 2000. Producer prices plunged to 22-year lows in late 1999 and early 2000, well below forfeiture levels (*Charts 3, 4*). USDA purchased a modest amount of surplus sugar in June of 2000, but it was too little too late. Producers forfeited to the government unprecedented amounts of beet and cane sugar under loan – nearly 10% of the crop – during July-September 2000.

The prolonged period of low prices during 1999-2001 had a profound effect on the U.S. sugar producing industry:

- Nineteen beet or cane processing mills closed between 1996 and 2001 -- more than a fourth of all the mills operating in 1996 (*Chart 5*). Some areas have exited the sugar business – portions of Hawaii cane and California beets; all of Texas beets. Other areas, such as Louisiana cane, have concentrated production at the most efficient mills.

- Independent beet processing and cane refining companies that despaired of low refined sugar prices, and sought to sell, found no independent buyers. Beet and cane growers, fearing that all their investment in growing sugarbeets and growing and processing sugarcane would be lost, organized cooperatively to purchase sugar-refining facilities. As recently as 1999, 36% of the refined sugar sold in the United States was grower owned. Currently the grower-owned share of U.S. refined sugar sales is double that, at 73% – the cane share has grown from 14% to 59%; the beet share from 65% to 90% (*Chart 6*).
- U.S. sugar production declined sharply in 2001 and 2002, from over 9 million short tons on 1999/00 to 7.9 million tons in 2001/02.

Modest Price Recovery. Prices were still mired within the potential loan-forfeiture range in the late summer of 2002 when USDA announced its intention to set the initial overall allotment quantity for fiscal 2003 at a conservative level. Though the allotments would not go into effect until October 1, the reaction of the market was immediate and constructive. Prices last fall recovered to slightly above forfeiture levels.

The market, meanwhile, has been amply supplied. There has been no shortage of refined sugar available to food manufacturers and retailers. For example, refined sugar has constantly been available from cane sugar refiners, who are not constrained by marketing allotments.

Methodology. We commend the Department for taking the conservative approach. Given the unpredictabilities of commodity markets, it was wise of the Administration to set a conservative OAQ until more would be known about domestic production and imports. In minimizing its risk of forfeiture, the Department is complying with Congress' intent that U.S. sugar policy not cost American taxpayers a dime.

We endorse the Administration's current approach in its operation of the marketing allotments program. We believe it is appropriate to allow the Secretary discretion to determine OAQ, and TRQ, amounts that balance the market under changing conditions and that avoid loan forfeitures.

We regard it as unnecessary, and, in fact, as potentially dangerous, to burden the Secretary with specific triggers – stocks/use ratio, price, or other – to force the Secretary to alter the OAQ amount. USDA analysts are capable of assessing U.S. market forces and anticipating loan-forfeiture risk. In a market undergoing enormous structural change, and in a market that is sometimes thinly traded, it

would be dangerous to put too much emphasis on a specific statistical trigger and limit the Department's flexibility and judgment.

TRQ Management. Some sweetener user corporations may call for an increase in the TRQ to reduce producer prices. But Congress' instruction in this regard is quite clear. *If the beet or cane sector is unable to fulfill its allocation, and the CCC has no sugar in inventory, then, and only then, should the Department make up any shortfall by increasing the TRQ.*

We would note that, in order to defend the important U.S. cane refining industry, a shortfall in either the cane or beet sector cannot be filled with sugar from the other domestic sector, but rather with imported raw sugar through an increase in the TRQ.

Price Ceiling, But Not a Floor. Sugar price behavior in 1999-2000, with prices falling so far below forfeiture levels, sadly reinforced the fact that the sugar loan program has long functioned as a price ceiling, but *not* as a floor.

Only the 10% of sugar production that was forfeited in 2000 achieved the intended price floor; much of that crop was sold at much lower prices. For example, USDA purchased significant quantities of refined beet sugar for as little as 17 cents per pound in 2000, despite a beet sugar loan rate of 22.90 cents per pound. Processors are limited in how much sugar they can forfeit, because of limited storage (processors must store the sugar they forfeit) and because of forward-contract commitments to customers.

When prices rise, on the other hand, the government increases supplies, through increases in the TRQ or, more recently, the overall allotment quantity. The increases in foreign or domestic supplies effectively cap the price rise.

Price behavior thus far in 2003 is a prime example of the price-cap effect. The January-11 USDA announcement that it would increase the OAQ and liquidate the remaining sugar in CCC inventory brought to a halt the 5-month long price recovery movement – capping prices, but, fortunately, not driving prices back into forfeiture territory (*Charts 3, 4*).

Future Prices, Survival Strategies. This price-cap effect will make it difficult for sugar producers to survive in the face of rising costs. While nominal sugar prices have declined modestly, general inflation since the last sugar price-support increase in 1985 has been 67%. So real prices are down dramatically (*Charts 7, 8*).

Marketing allotments will make it harder for producers to reduce costs by maximizing throughput and improving efficiencies of scale. Production increases cannot exceed the rate of consumption growth.

Nonetheless, a stable price horizon in the future should make producers more willing to continue to invest in technological advances to increase efficiency and reduce costs. With American sugar farmers now so vertically integrated into refined sugar sales, farmers are heavily leveraged and more committed than ever to maintaining a stable U.S. sugar market.

Even stable prices make farmers no less vulnerable to weather catastrophes. Sugar farmers are suffering through these in two major growing areas. A four-year drought has decimated production in six beet states: Oregon, Idaho, Montana, Wyoming, Colorado and Nebraska. For Louisiana cane, it's been the opposite disaster: two hurricanes followed by torrential rains last fall. Growers in both regions are struggling to survive.

Taxpayer/Consumer Benefits. While U.S. sugar policy has benefited taxpayers as the only major program crop that has been a net revenue raiser over the past decade (*Chart 3*), consumers have benefited from ample, high-quality sugar supplies at steady, low prices.

U.S. retailed refined sugar prices:

- Are virtually unchanged since the early 1990's;
- Are 22% below the average of foreign developed countries (*Chart 9*);
- Should be lower still, but grocery chains are not passing along to consumers the lower prices they pay for the sugar they purchase from producers. In fact, the gap between wholesale and retail refined sugar prices is rising dramatically. The 1982-84 3-year average gap between wholesale and retail refined sugar prices was 9 cents per pound; the average gap in 2000-02 was more than double that, at 20 cents per pound. This represents a massive transfer of revenues from sugar farmers and consumer to grocery chains (*Chart 10*).

About 40 percent of U.S. sugar is consumed directly as sugar. The majority is consumed in the form of sweetened products. The lack of passthrough to consumers of any benefit from low producer prices for sugar is just as apparent in sweetened-product price behavior as it is in the price of a bag of sugar on the grocery store shelf. Again looking back over two decades of data, retail sweetened-product prices have, on average, *risen* 78% since 1982-84, while

producers' wholesale prices are have *fallen* 12% (*Chart 11*). Food manufacturers and retailers have been able to raise prices to keep pace with inflation; producers have not, and have lost ground – many have gone out of business (*Chart 12*).

The passthrough data unequivocally refute the argument of some sugar policy critics – that reducing sugar producer prices will benefit consumers. Reducing producer prices for sugar only helps food manufacturer and retailer profit margins.

Marketing Allotment Program Implementation Challenges

Marketing allotments are on unless triggered off. Allotments are lifted when imports of sugar for domestic food use exceed 1.532 million short tons – the WTO minimum of 1.256 million tons, plus up to 276,000 tons from Mexico under the NAFTA. USDA has some additional flexibility: Imports can exceed the trigger level, without triggering off allotments, if the import increase does not cause a reduction in the OAQ.

The trigger amount includes not only the sugar TRQ, but also imports of “non-program” sugar, essentially “circumvention sugar” and “tier-2 sugar.” Significant imports of either could trigger off marketing allotments, oversupply the domestic market, depress prices, and render USDA incapable of operating a no-cost sugar policy.

TRQ Circumvention. The sugar TRQ has been circumvented by sugar imported in blends or products which have no commercial use in the form in which they are imported, but from which sugar is extracted for domestic food sales.

Court rulings in 2001 and 2002 addressed the years-long problem of “stuffed molasses” – a product concocted in Canada from world dump-market sugar and exported to the U.S. for the sole purpose of extracting sugar for sale at higher U.S. prices. But mimic products have been created and others, no doubt, are being planned. USDA has identified a product referred to as high-test molasses that is being imported from Mexico and Canada, outside the TRQ and at world dump-market prices, but solely for the purpose of extracting sugar for sale at the U.S. domestic price. USDA estimates the sugar content of these product entries at 50,000 tons this year.

Non-TRQ, circumvention imports have several possible negative consequences:

- When U.S. import needs are *above* the minimum TRQ, the circumvention products cut into the legitimate share of the U.S. market, at the U.S. price, by the 40 traditional quotaholding countries.

- When our TRQ is *at the minimum*, the circumvention imports cut into the OAQ – the domestic producers’ share of their own market.
- If the circumvention products push imports above the 1.532 million tons and marketing allotments are triggered off, the domestic market is potentially oversupplied and the Department’s ability to operate a no-cost sugar policy is compromised. (Circumvention products would have pushed imports above the trigger level this year had Mexico been granted its full potential NAFTA access of 276,000 short tons.)

The so-called “Breaux language” of the Trade Act of 2002 (Section 5203), passed last July, provides the Administration the ability to prevent these imports from undermining its ability to operate a no-cost sugar policy. The Trade Act requires the Administration to monitor sugar-product imports, identify any possible circumvention products, and recommend to Congress the best way to curb these imports.

We urge the Administration to implement aggressively the Congressional directive against import-quota circumvention – a factor critical to the Administration’s ability to operate U.S. sugar policy at no cost to taxpayers.

Tier-2 Imports from Mexico. The U.S. second tier, or above-quota, sugar tariff relative to the rest of world is 15.36 cents per pound, raw value, having been reduced 15% since 1995 under WTO rules. But relative to Mexico, the second-tier tariff has dropped to 7.56 cents, and will fall to zero in 2008, under NAFTA rules (*Chart 13*). With world dump market raw sugar prices languishing around 7 cents per pound, and U.S. prices running lower than Mexican prices but still about 21 cents, the temptation exists for Mexico to ship surplus sugar to the United States rather than the world market, pay the second-tier tariff, and still gain a return a few cents higher than the world market.

The potential consequences from imports of tier-2 sugar are identical to those described above for circumvention sugar.

Though Mexico currently has little surplus sugar to send – the result of a disappointing harvest and renewed demand for sugar in Mexican soft drinks – a production rally or a softening of the special tax on soft drinks made with corn sweetener could change that situation abruptly. A surge of second-tier sugar from Mexico would trigger off U.S. marketing allotments, oversupply the U.S. market, depress prices, and undermine the no cost operation of U.S. policy and the viability of American sugar producers.

We pledge our support for the Administration's continuing effort to negotiate with the government of Mexico a comprehensive, permanent agreement that addresses the potent threat of tier-2 sugar, restores access to Mexico for U.S. corn sweeteners, and restores balance and stability to an integrated U.S.-Mexican sugar and corn sweetener market.

Potential Minimum-TRQ Increases. Future increases in the minimum TRQ, through WTO, bilateral, or regional trade negotiations, could trigger off marketing allotments, or could force a change in the law to increase the import trigger level and reduce American sugar farmers' share of their own market.

As we have since 1986, we endorse the goal of genuine global free trade in sugar, absent all government intervention. Only comprehensive, multilateral, sector-specific negotiations – all countries, all trade-distorting practices – can achieve this goal and we urge the Administration to concentrate on this strategy regarding global sugar subsidies.

A piecemeal approach, through bilateral and regional trade agreements, can only distract from the comprehensive free trade goal, make the countries within these smaller agreements more vulnerable to subsidies outside the free-trade subregion, and reduce leverage to eliminate third-country subsidies. Furthermore, the countries on the current U.S. FTA list could overwhelm the U.S. sugar market – producing 50 million metric tons of sugar per year and exporting 25 million – more than double total U.S. sugar consumption (*Chart 14*).

We urge the Administration to reserve sugar for comprehensive, sector-specific negotiation in the WTO, and not in bilateral and regional trade agreements.

Conclusion

The U.S. sugar-producing industry commends the Department for its implementation of U.S. sugar policy under the 2002 Farm Bill. USDA is complying with Congressional intent in administering a program that provides American sugar farmers with some price stability and food manufacturers, retailers, and consumers with ample supplies of high-quality sugar at low, stable prices – all at zero cost to American taxpayers.

We recommend that the Administration continue to implement the marketing allotment program as it has been doing.

Thank you for the opportunity to present our views.

Chart 1

Sugar Votes, 1996-2001

HOUSE

	<u>Vote</u>	<u>% of Votes Cast</u>
Farm Bill, February 1996	217 - 208	51%
Ag. Appropriations, July 1997	253 - 175	59%
Ag. Appropriations, June 1998	258 - 167	61%
Farm Bill, October 2001	239 - 177	57%

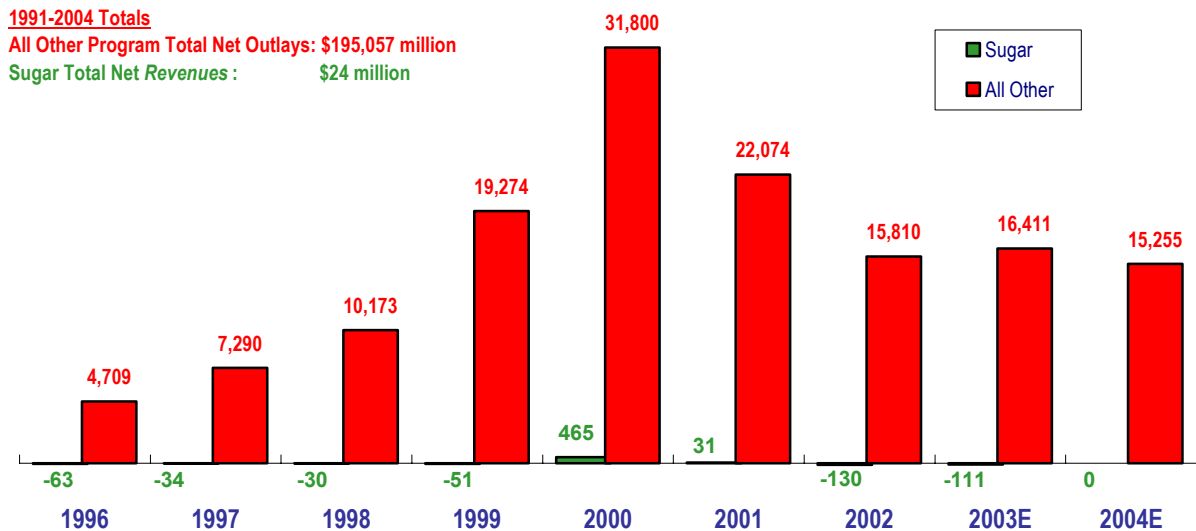
SENATE

Farm Bill, February 1996	61 - 35	63%
Ag. Appropriations, July 1996	63 - 35	64%
Ag. Appropriations, August 1999	66 - 33	67%
Ag. Appropriations, July 2000	65 - 32	67%
Farm Bill, December 2001	71 - 29	71%

Chart 2

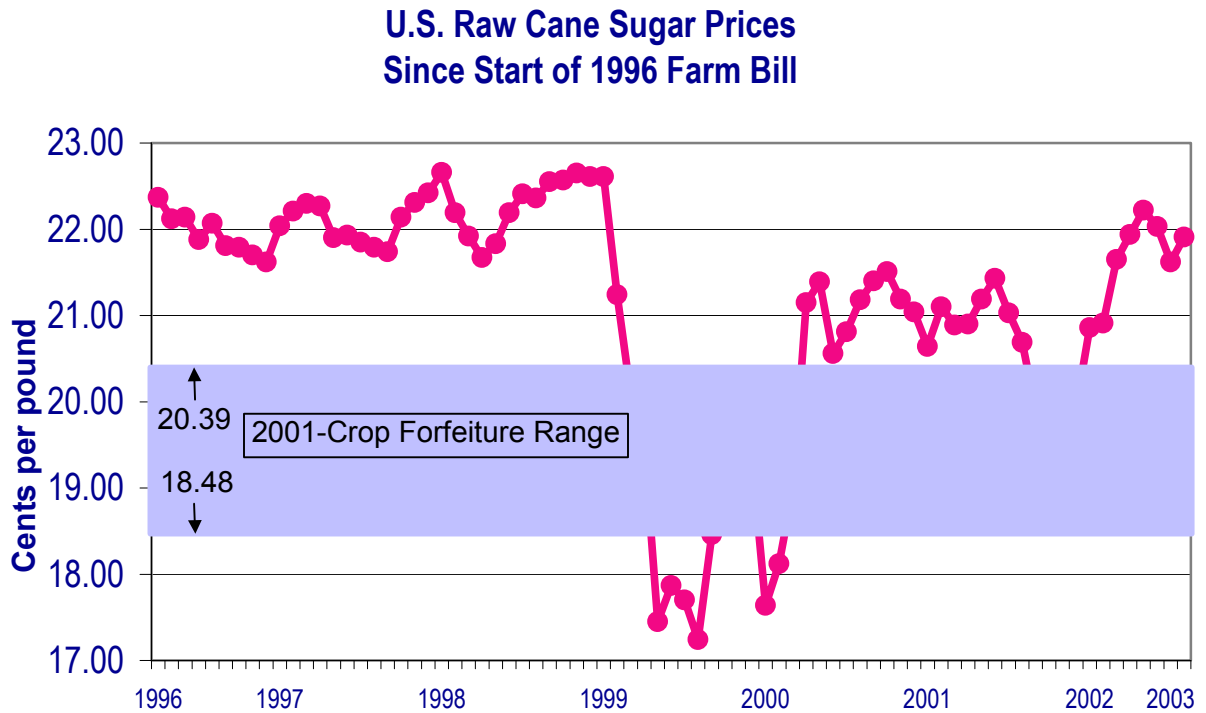
Government Net Outlays for Sugar and All Other Commodity Programs, 1996-2004

- Million dollars -



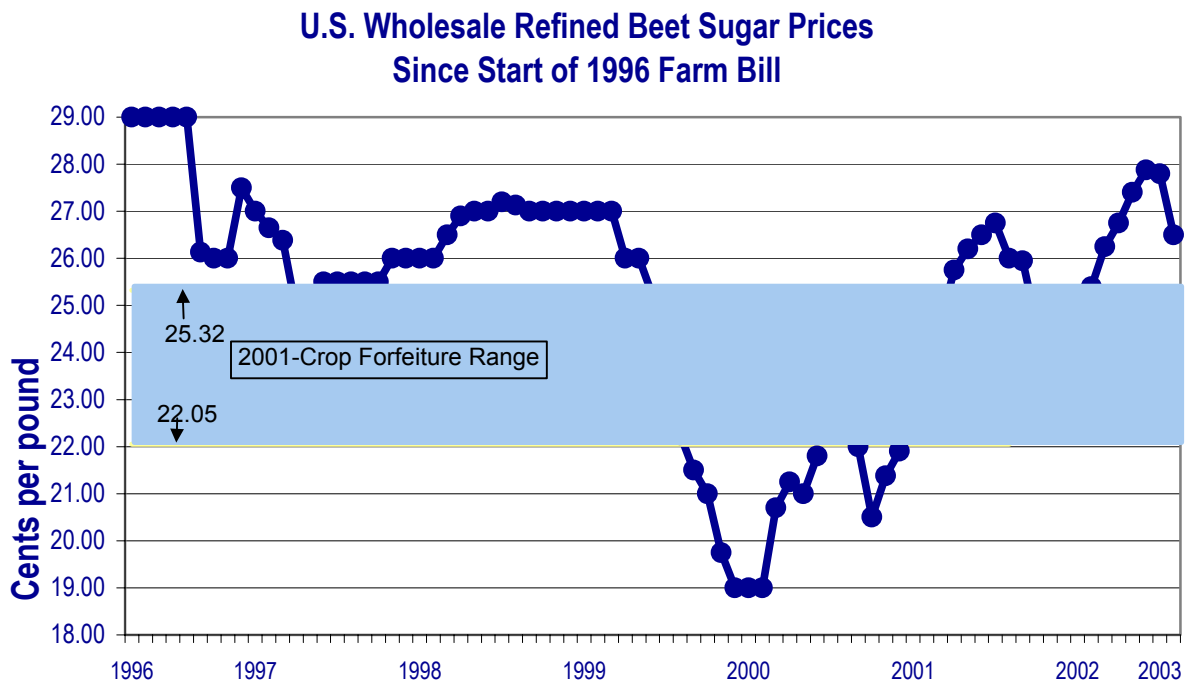
Data source: USDA/FSA, 2/3/03; All commodities net outlays 1991-95: \$52.2 billion. Sugar: 1991-99 – revenues from sugar marketing assessment tax (1991-95 revenues: \$101 million); 2000-01 – value of sugar forfeited to, or purchased by, government, plus storage costs; 2002-03 – revenues from sale of CCC sugar onto market at a profit.

Chart 3



Source: USDA. Raw cane sugar, nearby #14 contract, delivered New York. Monthly average prices October 1996 - February 2003.

Chart 4



Source: USDA. Wholesale refined beet sugar, Midwest markets. Monthly average prices October 1996 - February 2003.

Chart 5

19 Permanent Sugar Mill Closures Since 1996

BEET CLOSURES

Spreckels Sugar, Manteca
 California, 1996

Holly Sugar, Hamilton City
 California, 1996

Western Sugar, Mitchell
 Nebraska, 1996

Great Lakes Sugar, Fremont
 Ohio, 1996

Holly Sugar, Hereford
 Texas, 1998

Holly Sugar, Tracy
 California, 2000

Holly Sugar, Woodland
 California, 2000

Western Sugar, Bayard
 Nebraska, 2002

*In 2003, 27 beet and 25 cane mills remain

CANE CLOSURES

Ka'u Agribusiness
 Hawaii, 1996

Waialua Sugar
 Hawaii, 1996

McBryde Sugar
 Hawaii, 1996

Breaux Bridge Sugar
 Louisiana, 1998

Pioneer Mill Company
 Hawaii, 1999

Talisman Sugar Company
 Florida, 1999

Amfac Sugar, Kekaha
 Hawaii, 2000

Amfac Sugar, Lihue
 Hawaii, 2000

Hawaiian Commercial & Sugar, Paia
 Hawaii, 2000

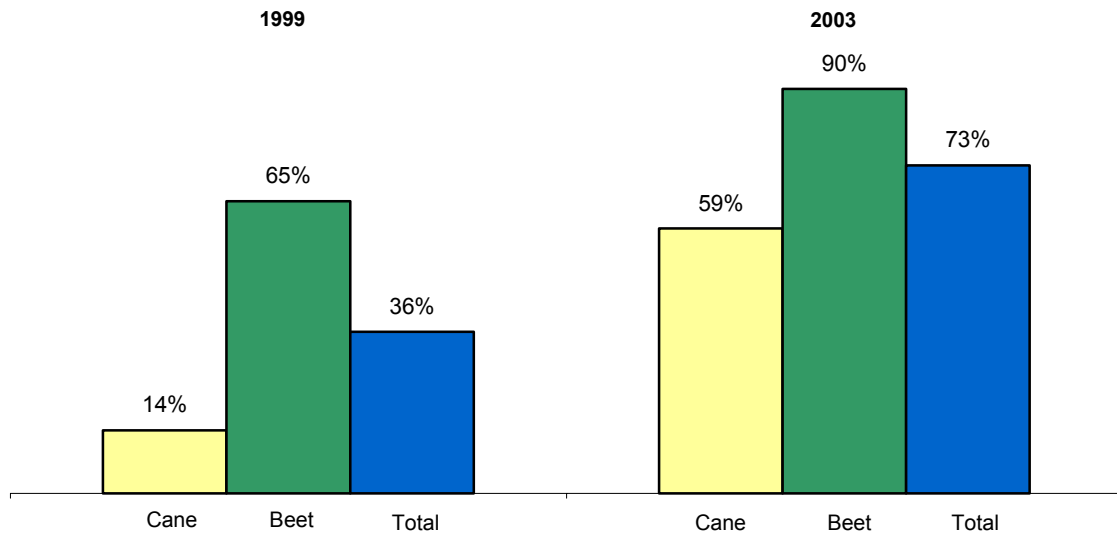
Evan Hall Sugar Cooperative
 Louisiana, 2001

Caldwell Sugars Cooperative
 Louisiana, 2001

Chart 6

U.S. Refined Sugar Sellers: Grower-Owned Share Doubles in Four Years

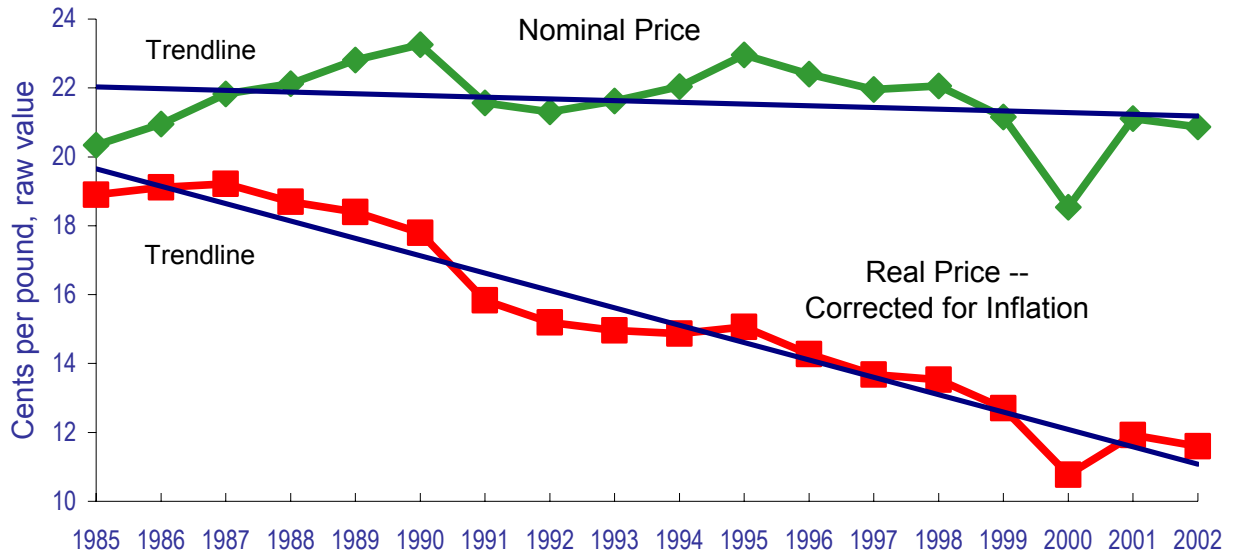
(% of production capacity)



Source: Production capacity estimates from McKeany-Favell Company, Inc. American Sugar Alliance, March 2003.

Chart 7

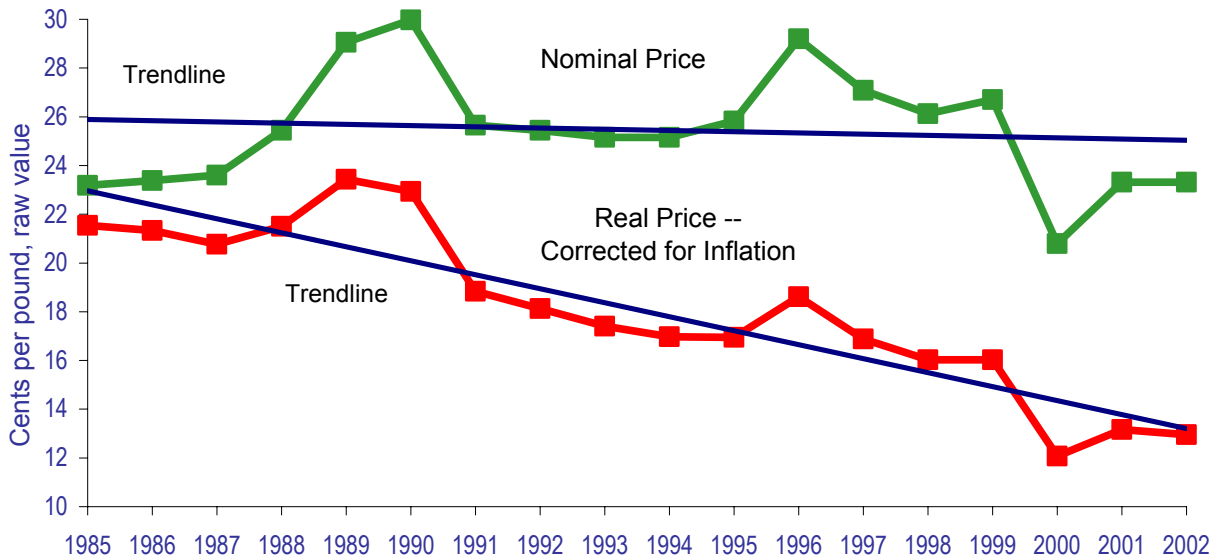
U.S. Raw Sugar Prices, Nominal and Real, 1985-2002



Data Sources: USDA, BLS. Price delivered New York, duty-free paid. Annual averages, 1985-2002, adjusted by CPI-U.

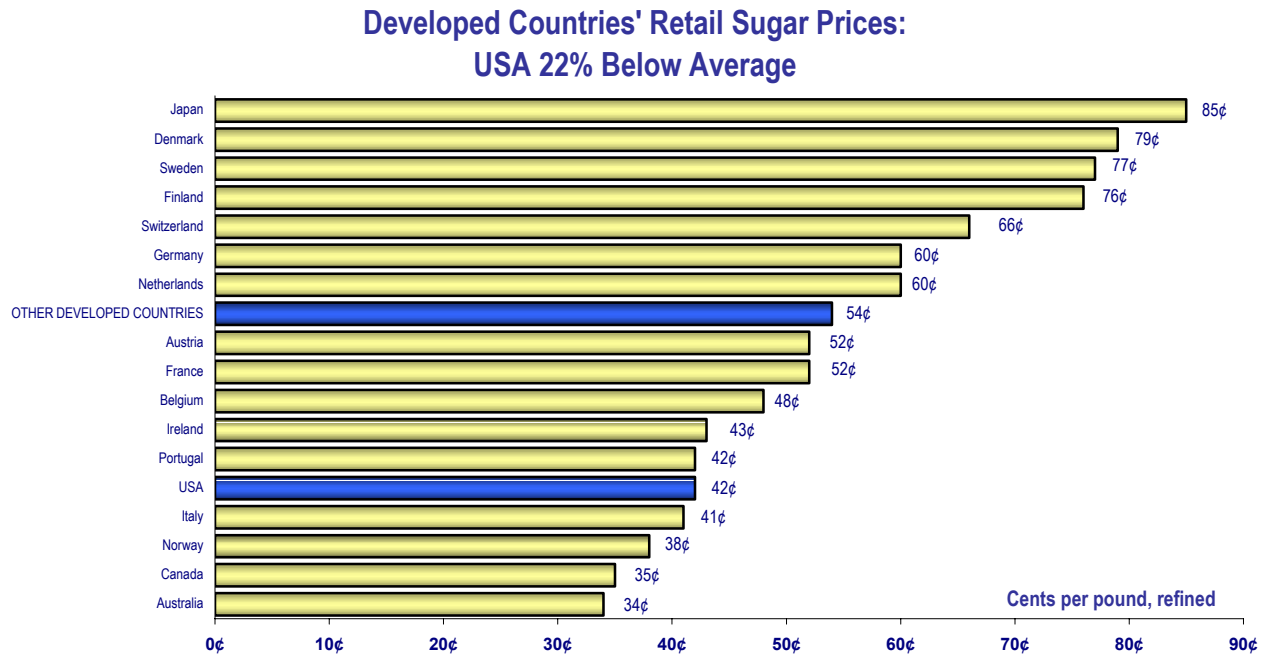
Chart 8

U.S Wholesale Refined Sugar Prices, Nominal and Real, 1985-2002



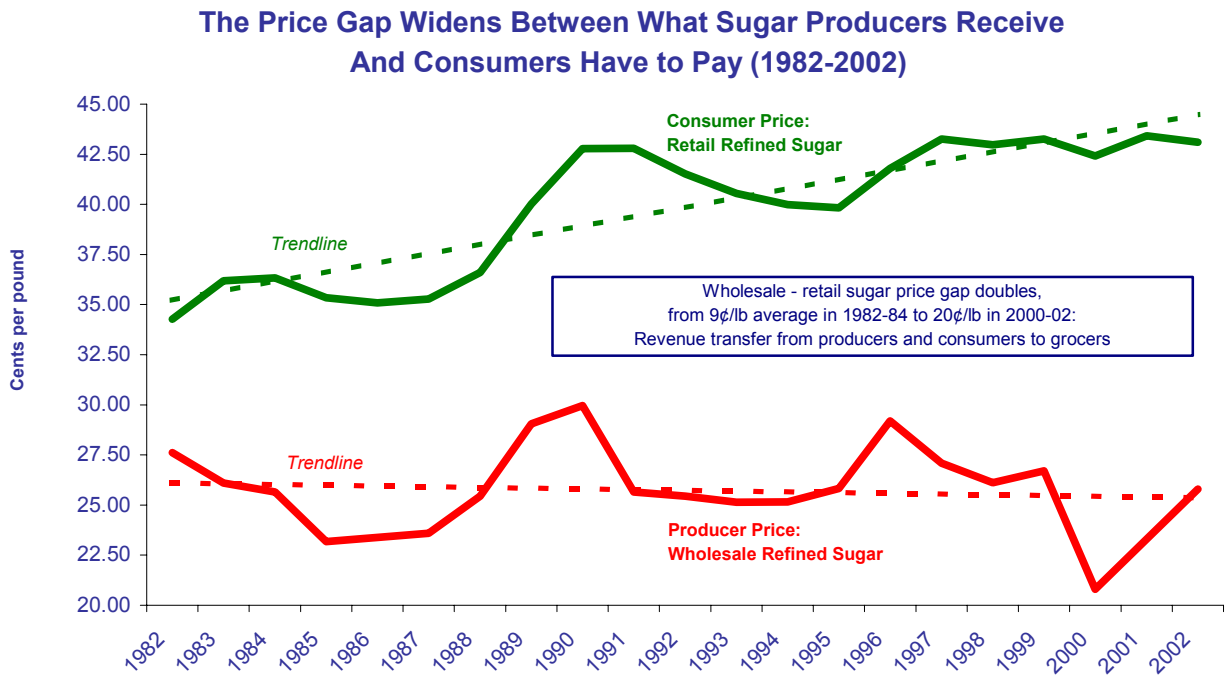
Data sources: USDA, BLS. Wholesale refined beet sugar, Midwest markets. Annual averages, 1985-2002, adjusted by CPI-U.

Chart 9



Source: LMC International Ltd., Oxford, England, February 2003; 2002 prices.
 "Other Developed Countries" represents the weighted average of 21 foreign developed countries.

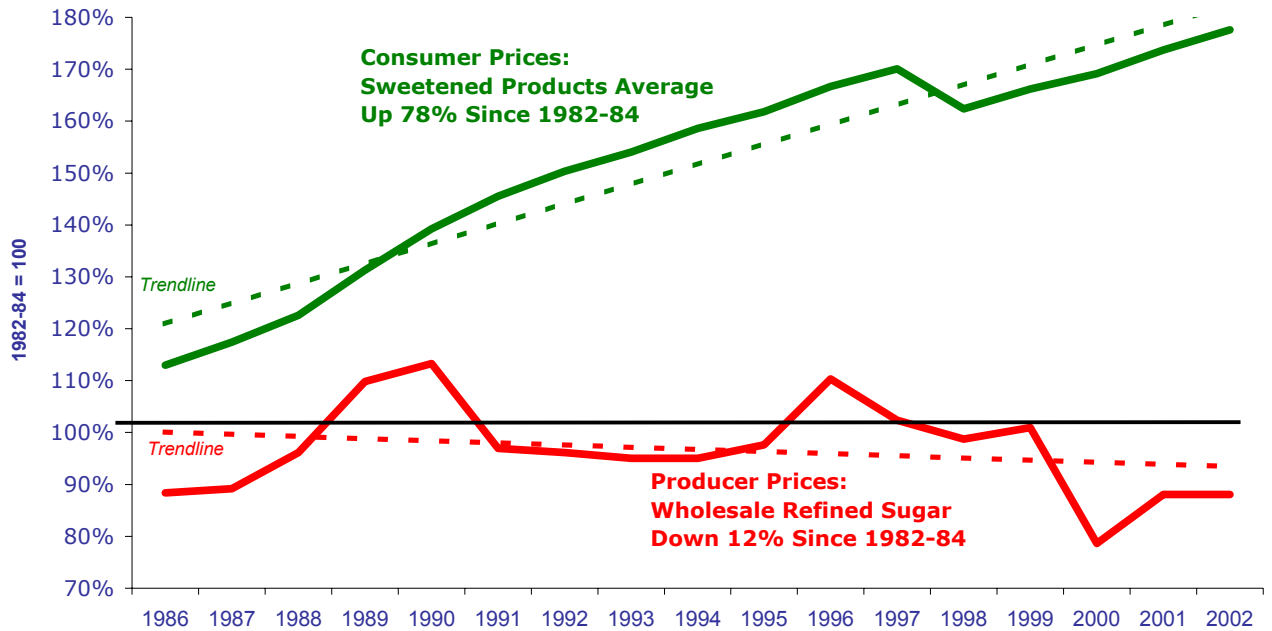
Chart 10



Sources: USDA, BLS. Wholesale refined beet sugar, Midwest markets; U.S. retail refined sugar. Annual average prices 1982 - 2002. Linear trendlines.

Chart 11

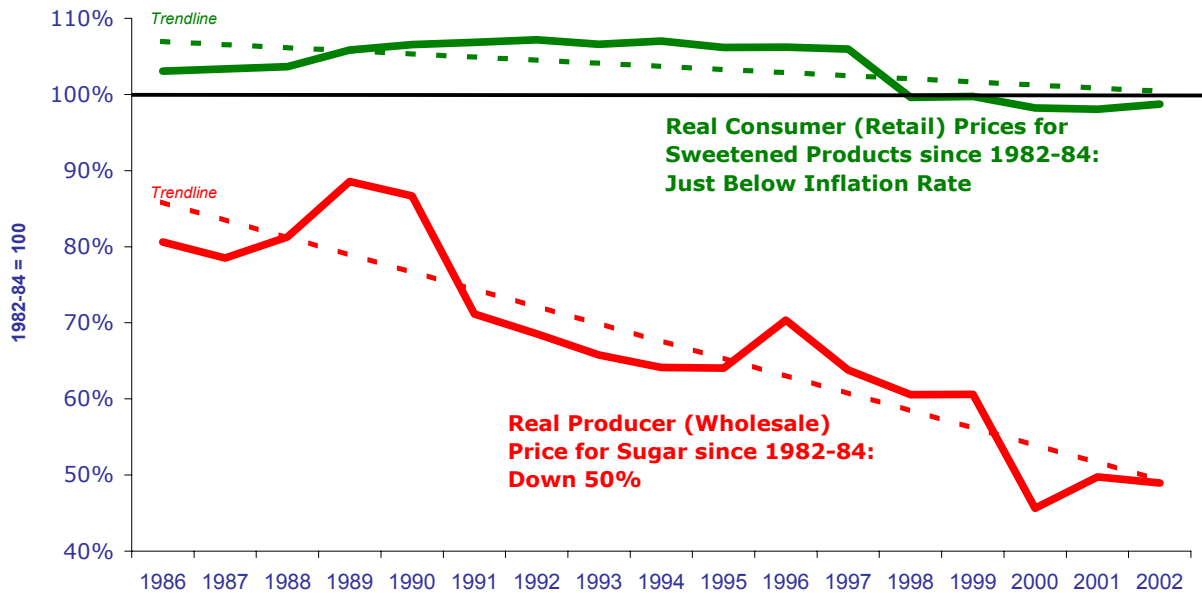
The Price Gap Widens Between What Sugar Producers Receive and Sweetened-Product Consumers Have To Pay (1982-2002)



Data Sources: USDA, BLS. Nominal prices; Annual averages, 1986-2002. Producer prices: Midwest markets. Consumer prices: Average of five major BLS sweetened product categories: Candy; Cookies and Cakes; Other Bakery Products; Cereal; Ice Cream.

Chart 12

Real Price Changes: Sugar Producers Hammered by Inflation; Sweetened-Product Manufacturers Keep Pace (1982-2002)



Data Sources: USDA, BLS. Annual averages, 1986-2002, adjusted by CPI-U. Producer prices: Midwest markets. Consumer prices: Average of five major BLS sweetened product categories: Candy; Cookies and Cakes; Other Bakery Products; Cereal; Ice Cream.

Chart 13

**U.S. Sugar Imports: Second Tier Duties
(Cents per pound of raw cane sugar, 96 pol)**

	Most Countries	Mexico
Base	18.08	16.00
1994	--	15.60
1995	17.62	15.20
1996	17.17	14.80
1997	16.72	14.40
1998	16.27	14.00
1999	15.82	13.60
2000	15.36	12.09
2001	15.36	10.58
2002	15.36	9.07
2003	15.36	7.56
2004	15.36	6.04
2005	15.36	4.53
2006	15.36	3.02
2007	15.36	1.51
2008	15.36	0.00

Source: USDA

Chart 14

**Potential U.S. Free-Trade Agreement Countries/Regions:
 Sugar Production and Exports and
 Share of U.S. Sugar Import Quota
 2000/01 - 2002/03 Average**

<u>Country</u>	<u>Production</u>	<u>Exports</u>	<u>U.S. TRQ Allocation</u>
		-Metric Tons-	
Mexico	5,128,000	246,000	7,258
Canada	94,000	5,000	---
Caribbean*	864,000	487,000	237,760
Central America	3,633,000	2,168,000	168,486
South America	25,917,000	12,376,000	313,579
FTAA Total	<u>35,636,000</u>	<u>15,282,000</u>	<u>727,083</u>
South Africa	2,741,000	1,388,000	24,221
Swaziland	537,000	253,000	16,850
SACU Total	<u>3,278,000</u>	<u>1,641,000</u>	<u>41,071</u>
Australia	4,600,000	3,456,000	87,402
Thailand	6,030,000	4,085,000	14,743
FTA Total	<u>49,544,000</u>	<u>24,464,000</u>	<u>870,299</u>

* Excluding Cuba

Data Source: USDA/FAS, November 2002