

# CRS Issue Brief for Congress

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## **Sugar Policy Issues**

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Remy Jurenas  
Resources, Science, and Industry Division

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CRS Electronic Briefing Book on Agriculture Policy and the Farm Bill, Sugar Program

## Sugar Policy Issues

### SUMMARY

Authorized by the 1996 farm bill, 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 which allows 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 affect the competitive position of the domestic sugar producing sector.

Record domestic sugar production, combined with imports of sugar permitted under trade agreements or not subject to limitation, contributed to a substantial oversupply in 1999/2000. Since the U.S. government could not further reduce imports to accommodate higher domestic sugar output without breaking its commitment made under World Trade Organization rules, USDA intervened to bolster market prices that had fallen below effective price support levels. Government sugar purchases, and paying 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. Some exercised their right to “forfeit” 10% of FY2000 sugar output, and USDA recorded significant program outlays.

Disagreement over how USDA handled

the sugar oversupply situation reflects continued fundamental differences between the growers and processors on one side, and sugar users (primarily food manufacturers) and some cane refiners on the other side, over what U.S. sugar policy should be. Though some program changes were made during 1996 farm bill debate, opponents each year since mounted legislative challenges to modify or eliminate the program. All failed on recorded votes. Program supporters reversed two 1996-enacted changes in spending bills.

Lower 2001/02 sugar production has resulted in a recovery in domestic sugar prices, particularly for refined beet sugar. The decline in the projected output largely reflects the impact of last fall’s sugar PIK program. Also, if and how two sweetener trade disputes with Mexico are resolved will affect future U.S. sugar supply and price prospects.

Affected interest groups have sought to shape future sugar policy as Congress has considered a new multi-year farm bill. Growers and processors stress the industry’s importance in providing jobs and income in rural areas. Sugar users and their allies argue U.S. sugar policy costs consumers and results in lost jobs at food firms in urban areas. The sugar production sector proposal (largely incorporated in the farm bill) called for resolving trade disputes, retaining the current level of price support protection, and relying on domestic marketing controls to control supplies as the basis for future policy. Program opponents advocated various approaches to reduce the level of price support and/or phase out the program by mid-decade. During floor debate, the House and Senate rejected efforts by opponents to reduce the level of sugar price support and/or to phase out the program.

## MOST RECENT DEVELOPMENTS

*Farm bill conferees on March 19, 2002, settled upon a tentative framework for allocating funding by major category, including amounts for commodity programs. In particular, the agreement allocates \$2.6 billion for the peanut, sugar, and dairy program provisions added by the Senate's farm bill (S. 1731) to the funding related to these three program's provisions included in the House farm bill (H.R. 2646). Conferees now face the task of dividing this amount among these three programs, with a final decision on resources actually available for the sugar program not expected until mid April at the earliest.*

## 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 and foreign suppliers shared the U.S. sugar market in a roughly 55 / 45% split, respectively. This, though, has not been the case in recent years. In FY2001, domestic production filled 88% of U.S. sugar demand for food and beverage use; imports covered 12%. As high-fructose corn syrup 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.

U.S. sugar policy maintains domestic sugar prices 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 than they would if imports entered without any restriction. How competing interests view this issue undergirds much of the public debate on sugar policy.

## Current Sugar Policy

### 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. Current program provisions apply through the 2002 crops.

The first required USDA to make *recourse* loans available to processors (through FY2000) whenever it announces 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 effective, recourse loans provide no price floor to processors, even if market prices fall below specified levels. If USDA announces an import quota of 1.5 million ST or more, *non-recourse* loans (the type of loan available under pre-FY1996 policy) automatically would become available to processors. Non-recourse loans provide a price guarantee to a processor whenever market prices fall below the same specified 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 price prospects worsened during FY2000, the sugar production sector sought and succeeded in having Congress repeal USDA’s authority to make recourse loans (Section 836 of P.L. 106-387 – FY2001 agriculture appropriations).

The second change required USDA to impose about a 1 cent per pound penalty on any processor forfeiting sugar to the Commodity Credit Corporation (applicable only when 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 reduces 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 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 was placed under loan earlier in the year. To exercise this right to forfeit on these loans, processors paid \$18.7 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 affect market prices, and are made to ensure that growers and processors realize the benefits of price support they expect to receive, 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 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 last farm bill froze price support — 18 cents per pound for raw cane sugar and 22.9 cents/lb. for refined beet sugar — at 1995 levels for 7 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 levels (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, USDA’s aim is to support the raw cane sugar price (depending upon the region) at not less than 19.1 to 20.7 cents/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 *less* a forfeiture penalty applicable under certain circumstances). Similarly, USDA seeks to support the refined beet sugar price at not less than 23.2 to 26.2 cents/lb. (i.e., the regional loan rate *plus* specified marketing costs *plus* the interest paid on a price support loan *less* the forfeiture penalty), depending on the region. USDA seeks to meet these “loan forfeiture,” or higher “effective” price support, levels by limiting the amount of foreign raw sugar imports allowed into the United States for refining and sale for domestic food and beverage consumption. A loan forfeiture (turning over sugar pledged as loan collateral) occurs if a processor concludes that domestic market prices at the time of a desired sale are lower than the “effective” sugar price support level implied by the loan rate.

**Import Quota.** USDA restricts the quantity of foreign sugar allowed to enter the United States to ensure that market prices do not fall below the above levels of effective price

support. 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 domestic producing sector from the entry of additional foreign sugar.

USDA on September 18, 2001, set the FY2002 tariff-rate quotas for sugar imports (raw and refined) at 1,420,861 ST, raw value. 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**). The 1.42 million ST represented by the sugar TRQs is expected to account for some 14% of U.S. food consumption in FY2002.

**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. For FY2001, budget analysts project the CCC will spend about \$15 million to store its sugar inventory. Earlier, during most of the decade (FY1991-99), the sugar production sector paid more 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. 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.<sup>1</sup> In a policy change that the sugar production sector sought, 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. This policy effectively continues in FY2002 under a provision found in the FY2001 agriculture spending measure (P.L. 107-76).

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<sup>1</sup> The peanut sector still pays a similar assessment; authority to collect an assessment from the dairy and tobacco sectors expired in 1996 and 1998, respectively.

## Sugar Industry, Market, and Program Developments

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

Congressional debate over sugar policy takes place against the backdrop of structural changes in the industry, historically low sugar prices caused by oversupply, and the inability of policymakers working within the current U.S. sugar policy 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.

**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 fall 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 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 recent 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 cancelled the proposed sale of its Western Sugar Company operations in Colorado, Montana, Nebraska, and Wyoming to a newly-formed farmer cooperative, but did complete 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 in late 2001.

**Low Sugar Prices and USDA's Responses.** Record U.S. sugar production in 1999/2000, when added to imports of sugar permitted to enter under quota or not subject to any limitation, contributed to a substantial oversupply of sugar in the U.S. market in FY2000, and to the fall in prices below effective price support levels and to the lowest levels seen since 1979. In FY2000, raw cane sugar prices were 17% below the previous 3-year average; refined beet sugar prices were 19% below. Since trade agreement obligations effectively removed USDA's ability to further limit the flow of imports, the sugar production sector sought government intervention sufficient enough to raise prices to avert the forfeiture of sugar pledged as collateral for non-recourse loans processors had taken out. (Forfeiture — handing over sugar to the CCC as repayment for the loan — becomes a financially attractive alternative to a processor if the market price is below the effective support (e.g., loan forfeiture) level when the loan comes due.) USDA responded with decisions to: (1) purchase sugar from cane and beet processors (May 2000) and (2) make “in-kind” payments of sugar



to beet farmers who agreed to plow under some of their to-be-harvested crop in order to reduce sugar output (announced in late July 2000). Since both actions did not raise market prices sufficient enough to allow processors to pay back all their price support loans, some exercised their right at the end of September 2000 to “forfeit” to USDA about 10% of 1999/00 sugar output. As a result, USDA recorded significant budgetary outlays in acquiring a substantial amount of sugar (1,090,320 ST, raw value). Subsequently, on December 1, 2000, under the “payment-in-kind” (PIK) program, USDA transferred almost 300,000 ST of sugar to sugar beet farmers (or their processors) who earlier had diverted almost 102,000 acres from production.

Though raw cane prices recovered to above loan forfeiture levels in the 2000/01 marketing year, refined beet prices did not rise above their forfeiture levels until late September 2000.<sup>2</sup> In order to reduce storage costs, bolster market prices, and alleviate the sugar oversupply situation, USDA announced in early June and late August 2001 three initiatives to dispose of its sugar inventory. First, it plans to sell up to 100,000 tons of refined sugar to ethanol producers, and to make available for sale another 40,000 tons (split equally between raw cane and refined beet) whenever specified market price levels are reached. To date, USDA has sold almost 10,000 tons of sugar for ethanol. Prices for raw cane sugar still are below levels to trigger sugar sales from USDA’s inventory; the recent surge in refined beet sugar prices (if sustained) has already led to sizable sales in the 2001/02 marketing season.

Second, USDA announced on August 31, 2001, it would implement another sugar PIK program similar to last year’s. It will let growers divert from production (e.g., plow under) part of their 2001 beet or cane crop in exchange for sugar still held in its inventory (then totaling 740,682 ST). USDA will make available a total of 200,000 ST to farmers placing accepted bids under this exchange. Each farmer will be limited to receiving a maximum \$20,000 value in sugar. The beet sector reportedly favored another PIK program, expecting to benefit from higher refined sugar prices; cane growers (operating much larger farms) did not. Fourteen congressman had earlier urged the Secretary of Agriculture not to move forward to implement this proposal, and called upon her “to use the present sugar industry problems as a call for comprehensive sugar reform in the upcoming Farm Bill debate.” Two Florida operations unsuccessfully sought in a lawsuit to prevent USDA from implementing this year’s PIK program, arguing that normal rule making procedures were not followed. This position reportedly reflects the view held by some in the sugar cane producing sector that PIK program rules favor smaller sugar beet producers. On September 28, USDA’s Farm Service Agency (FSA) announced that farmers had submitted enough offers to “divert,” or plow under, 106,541 acres of sugar crops. In return, FSA will transfer title to the entire 200,000 ST of sugar offered to those whose bids are accepted.

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<sup>2</sup> Because of low prices, one beet sugar refiner in Washington state “forfeited” some 2000 crop sugar pledged as collateral for price support loans taken out earlier. Unofficial data show that USDA’s Commodity Credit Corporation received title to over 34,000 tons of sugar valued at \$15 million.

## 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, the implementation of 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, cane refiners, manufacturers of corn sweeteners, and sugar users. These provisions are complex, reflect compromises in U.S. trade negotiating positions and the results of bilateral talks to resolve disputes, and affect in varying degrees the economic interests of all parties with a stake in U.S. sugar policy.

Trade in sweeteners does affect 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 are not subject to import restrictions, 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 intersecting with the debate on the future of the U.S. sugar program. Those 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 discussed at meetings held by both countries' presidents since the late 1990s.

Legislation passed by the Mexican Congress on January 1, 2002, to tax soft drinks containing corn syrup but not sugar for a while effectively eliminated the market for U.S. 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. Others 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. Among other sugar trade issues, 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 continues to receive congressional attention.

### **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 in this and coming years. 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 Mickey Kantor and Mexico's Secretary of Commerce and Development Jaime Serra Pucha. The side letter was included with other NAFTA agreement documents that President Clinton submitted to Congress together with the implementing legislation. Mexican negotiators instead refer to the sugar provisions of the final NAFTA agreement as concluded in August 1992 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 metric tons (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 sugar into an already surplus 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 over-quota sugar imports (e.g., price competitive in the U.S. market) from Mexico projected to occur in FY2004, and unlimited duty-free imports beginning in FY2008.

## **Circumvention of Sugar Import Quotas**

Controversy has surrounded the import by a Michigan company (Heartland By-Products, Inc.) since the mid-1990s of a liquid sugar syrup (i.e., "stuffed molasses"). This product is created from sugar imported at the low world price into Canada primarily from Brazil, mixed with molasses and water, and then shipped duty free to the United States taking advantage of a specific U.S. tariff provision. Using special equipment, this firm extracts sugar from this syrup and reportedly ships the remaining molasses back to Canada where the process starts over again. Concerned that this industrial-grade sugar sold to U.S. food companies displaces sales of domestically produced beet sugar (118,000 short tons in 1999/00), U.S. beet and cane refiners have sought a remedy to block its import. This amount equaled 1.2% of total domestic food use that year. Refiners have argued that stuffed

molasses is imported deliberately to circumvent the sugar TRQ, by entering under a tariff line that does not subject it to quota restrictions and high tariffs.

Seeking to “close this loophole,” these refiners since early 1998 have sought relief from U.S. Customs and then the courts. The apparent final step on this issue occurred on 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, upholding 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.”

Concerned that other firms might move to take advantage of other “loopholes,” the sugar production sector has continued efforts to seek a legislative remedy, arguing that imports of other sugar mixtures could undermine the domestic sugar sector and add 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 articles in proclaiming revisions to these quota provisions.

## Legislative Proposals and Debate Since 1996

The sugar program compromise enacted as part of the 1996 farm bill did not fully satisfy the three most directly affected and competing interest groups — growers and sugar processors, cane refiners, and sugar users. The *sugar production sector* contended that “recourse” loan policy, when in effect, would result in considerable price uncertainty. It also expressed concern that the forfeiture penalty would effectively result in a reduced level of price support, but indicated that most other provisions were acceptable. *Sugar users* contended that the proposed program offered little change from previous policy because price support levels were not lowered. *Cane sugar refiners* feared that retaining 1995 price support levels would result in the closure of more refineries, and further shrink U.S. cane refining capacity.

Since 1996, sugar users and cane refiners unsuccessfully sought to make changes to the sugar program during congressional consideration of successive agriculture appropriation bills in order to attain their lower market price objective. During the 106<sup>th</sup> Congress, the sugar production sector succeeded in persuading Congress to drop two farm bill provisions — the imposition of marketing assessments, and the requirement that USDA make recourse loans to processors under certain conditions.

Those that proposed changes contended that the 1996 farm bill did not “reform” the sugar program by providing a transition to the free market as it did for the other commodity programs. Program opponents maintained that the program continued to benefit a few wealthy growers, kept the cost of sugar high, and supported sugar cane production in Florida with adverse environmental consequences for the Everglades. Members that favored lower

sugar price support argued that consumers would pay less for sugar and sugar products, and reduce environmental damage in vulnerable producing areas.

Sugar program supporters countered that the changes proposed would devastate an efficient U.S. sugar industry by driving producers out of business, wreak havoc on industrial users who rely on critically timed shipments of sugar at prices below those found elsewhere in the developed world, and undermine the agreement on sugar policy made in the 1996 farm bill. They asserted that proposed reductions in price support would undercut the seven-year contract that Congress made in the farm bill, exposing producers and processors to unreasonable risk who assumed sugar policy would remain unchanged through 2002. They also argued that food companies would not pass on any savings to consumers if sugar price support levels were lowered.

## **Proposals Offered by Program Opponents**

During the 104<sup>th</sup> Congress, an amendment offered during House appropriations markup in May 1996 that effectively would have capped the raw cane sugar price at 21.15 cents per pound (included in the House-passed FY1997 agriculture appropriations bill - H.R. 3603) was dropped in the subsequent conference agreement with the Senate. Separately, an amendment offered in the Senate in July 1996 to this same measure effectively would have eliminated for most sugar processors the price support guarantee provided by non-recourse loans. This was tabled on a 63-35 vote.

During the 105<sup>th</sup> Congress, the House in July 1997 rejected on a 175-253 vote a floor amendment to the FY1998 agriculture spending bill (H.R. 2160) that would have required USDA to implement the sugar program on a recourse loan basis in FY1998. The House on June 24, 1998, rejected on a 167-258 vote a floor amendment to the FY1999 agriculture appropriations bill (H.R. 4101) that effectively would have reduced sugar price support levels by one cent per pound.

In the 106<sup>th</sup> Congress, the Senate on August 4, 1999, tabled 66-33 an amendment to S. 1233 (FY2000 agriculture appropriations) that effectively would have not allowed USDA to administer the sugar program in FY2000. The Senate on July 20, 2000, tabled 65-32 an identical amendment to S. 2536 (FY2001 agriculture appropriations). The House, earlier on June 20, tabled on a point of order an amendment to H.R. 4461 to limit USDA spending to purchase raw or refined sugar in FY 2001 to \$54 million, the amount spent on sugar purchases during FY2000.

## **Sugar Production Industry Changes Enacted**

The Senate, in adding a farm aid package to the FY2000 agriculture spending measure (H.R. 1906), included a temporary relief provision to effectively prohibit USDA from collecting the marketing assessment from sugar processors through FY2001, if the Office of Management and Budget determines that the federal budget is in surplus in FY2000. House and Senate negotiators retained this language, but dropped the condition that there be a budget surplus for the prohibition to be effective, in amending the farm aid package in conference (Section 803(b) of H.Rept. 106-354). Signed into law (P.L. 106-78) on October 22, 1999, processors expected to save (i.e., increase their revenues by) \$83 million over the 2-year period.

With the marketing assessment scheduled to kick back into effect on October 1, 2001, the sugar sector again sought to repeal this requirement. A provision to accomplish this was included in FY2001 emergency farm aid package proposals considered by the House and Senate Agriculture Committees (but not enacted), and is found in both the House and Senate farm bills. Based on the assumption that Congress will complete action on this measure within the next year that would include language to repeal this assessment, section 749 of the FY2002 agriculture appropriations measure (P.L. 107-76, H.R. 2330) simply defers processors' payment of this assessment until September 2, 2002.

Conferees to the FY2001 agriculture spending measure (H.R. 4461) added language to conference agreement text (Section 836) striking the recourse loan feature of the 1996-2002 sugar program. Members opposed to adding this provision argued that changes to 1996 farm bill authority should be made in the context of congressional consideration of the next farm bill. Supporters argued that continued low sugar prices and loan forfeitures by processors signaled that the production sector was in need of relief as much as the producers of other commodities that have received farm aid in recent years. Signed into law (P.L. 106-387) on October 28, 2000, this change means USDA has authority only to make non-recourse loans to sugar processors for the duration of current program authority.

## Sugar Program in the 2002 Farm Bill

The House and Senate, in passing their farm bills (H.R. 2646 on October 5, 2001, and S. 1731 on February 13, 2002, respectively), approved sugar programs that contain similar provisions. The new program would continue current price support levels and reactivate 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. 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 has questioned the practice of compensating growers for not harvesting a portion of their crop. Farm bill conferees shortly are expected to decide on how much of available budget resources to allocate to the proposed sugar program. This in turn will guide how they resolve the few differences that exist between House and Senate provisions.

### Major Provisions of the Proposed Program

Several sugar program provisions are identical in the House and Senate farm bills. Some extend aspects of the current program; others (including all those related to marketing allotments) are additions. Observers expect conferees to easily resolve most of the differences (see below) between measures, except possibly for the loan forfeiture penalty issue.

Provisions found in both bills include:

- (1) *price support* at current levels – 18¢ per pound for raw cane sugar, and 22.9¢ per pound for refined beet sugar.

- (2) *non-recourse loans* to processors of sugarcane and sugar beets (expanded to allow loans to be made also for in-process sugars and syrups at 80% of the applicable loan rate).
- (3) repeal of the sugar *marketing assessment* starting in FY2002.
- (4) the requirement that USDA operate the sugar program at *no cost* to the federal government (i.e., by avoiding loan forfeitures).
- (5) authorizing the use of two tools to accomplish this objective (requiring *marketing allotments* when imports are below 1.531 million tons to limit the amount of domestically-produced sugar that raw cane mills and beet refiners can sell, and allowing for the transfer of sugar in USDA's inventory to sugar processors that work in concert with producers of cane and beets who agree to reduce production of these crops – effectively codifying the *sugar payment-in-kind* mechanism). The 1996 farm bill suspended marketing allotment authority, which USDA exercised under different terms three times in the 1991-95 period.
- (6) a new *storage loan facility program* to provide financing to processors for constructing or upgrading facilities to store and handle raw and refined sugar, and
- (7) reducing the *interest rate* USDA charges on sugar price support loans by 100 basis points (1%).

The three major differences between the two measures are found in:

- the *duration of program authority*. The House farm bill would cover a 10-year period (the 2002 to 2011 crops), while the Senate measure would apply only to 5 years (the 2002 to 2006 crops).
- the status of the *loan forfeiture penalty* (see page 2 for explanation). The House retains this 1996 farm bill provision, while the Senate would repeal it. Observers note this is the most controversial sugar program provision facing conferees, with program opponents expected to make an effort to retain it as part of the program.
- the requirements prescribed for *allocating shares to cane states and beet processors*. Senate language details the formula for USDA to use to assign sugar marketing allocations to beet refining companies, and defines the rules for transferring allocations. The House grants considerable discretion to USDA to make allocations to beet refiners after consulting with them and growers.

Separately, there are four unique or clarifying provisions in the Senate's sugar program not found in the House measure that conferees will also look at. One restores a 1985 farm bill provision that required USDA to make payments to sugar beet farmers who are owed payments as a result of a processor going bankrupt. Another provides that a beet refiner's minimum payment to a grower shall not be more than the rate agreed upon in the contract signed between the refiner and grower (i.e., effectively allowing a processor to pay less than

the minimum support price). One set of provisions (added to address an initiative launched by a few cane growers in California) would allow for the establishment of a cane sugar allotment in a new cane-producing state and for providing the new cane processor with a first-time allocation. A fourth provision would explicitly allow a refiner to substitute refined beet sugar for cane sugar in meeting certain requirements under USDA's sugar re-export program (apparently intended to maximize use of refining capacity by companies that process and/or market both refined cane and beet sugar). Another Senate provision provides discretionary authority (modified on the floor from mandatory) to USTR to reallocate on or after June 1 of each year import quotas not used by recipient countries to other quota holding countries in order to cover shortfalls in sugar import shipments.

## **Background on Proposed Sugar Program**

The farm bill's sugar provisions reflect many of 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 commended committee and floor actions 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.”

## **Analysis of Proposed Program**

Looking at the features common in the farm bills approved by each chamber, the sugar program would guarantee price protection to farmers and sugar crop processors at currently-set levels (18 cents/lb. for raw cane, 22.9 cents/lb for refined beet). The Secretary of Agriculture would have authority to implement payment-in-kind programs that in time would result in the sale of the sugar remaining in CCC inventory to processors and remove its potential to dampen prices. The requirement to implement marketing controls on sugar may “lock” the domestic sugar production sector into a declining share of the U.S. market, as some have observed. These controls have the potential for substantially reducing the amount of sugar that U.S. processors can market starting as soon as FY2004, particularly if USDA intends to meet the program's no cost objective. Such a scenario could be mitigated to some degree if U.S.-Mexican trade negotiators reach an accommodation that slows down the pace of Mexican sugar allowed to enter the U.S. market.

## **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 on November 28.

### **H.R. 2081 / S. 1652 (Miller, Dan / Santorum)**

Sugar Program Reform Act. Amends the Agricultural Market Transition Act of 1996 to change the type of price support available for sugarcane and sugar beets from a nonrecourse loan program to a solely recourse loan program, to gradually reduce the level of price support available for sugarcane and sugar beets, and to eliminate the program after the 2004 crops of sugarcane and sugar beets. 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. 2646 (Combest)**

Agricultural Act of 2001. Title I, Subtitle C, Chapter 2 amends the Agricultural Market Transition Act of 1996 to authorize a non-recourse loan program for sugar crops through 2011 at current loan rate levels, reinstate the requirement that the sugar program be administered at no-net cost to taxpayers, eliminate the marketing assessment on domestically-produced sugar, authorize the USDA to transfer commodities in CCC inventory to farmers who agree to reduce production (i.e., payment-in-kind program), authorize loans for sugar storage facilities, and reduce the CCC interest rate on sugar price support loans. Other provisions amend the Agricultural Adjustment Act of 1938 to authorize the Secretary of Agriculture to establish marketing allotments for domestically-produced sugar to eliminate loan forfeitures when certain conditions exist. Amended and passed by voice vote by the Agriculture Committee 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.

### **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.

**S. 1571 (Lugar)**

Farm and Ranch Equity Act of 2001. Section 122 (e) amends sugar program authority to authorize only recourse loans for the 2003-2005 sugar beet and sugarcane crops, to “progressively and uniformly” lower sugar loan rates for each succeeding crop to zero for the 2006 crop, and to replace current price support provisions with authority to make producers of both sugar crops eligible for “vouchers of up to \$30,000 annually through 2006 to any farmer or rancher who signs a “risk management contract,” and who undertakes specified risk management activities. Introduced October 18, 2001; referred to Committee on Agriculture, Nutrition, and Forestry. Offered as an amendment (SA 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. Title I, Subtitle C, Chapter 3 authorizes a non-recourse loan program for sugar crops through 2006 at current loan rate levels, requires that the sugar program be administered at no-net cost to taxpayers, eliminates the marketing assessment on domestically-produced sugar at year-end 2003, authorizes the USDA to transfer sugar in CCC inventory to farmers who agree to reduce production (i.e., payment-in-kind program), authorizes loans for sugar storage facilities, repeals the loan forfeiture penalty, and authorizes USDA to establish marketing allotments for domestically-produced sugar when certain conditions exist to ensure that loan forfeitures do not occur. Committee approved entire farm bill by voice vote, and ordered it to be reported as an original measure in lieu of S. 1628, on November 15. Committee filed S.Rept. 107-117 on December 7. During floor debate on December 12, Senate tabled an amendment (S.Amdt. 2466) offered by Senator Gregg to phase out the sugar program and use any resulting savings to improve nutrition assistance on a 71-29 vote. Senate approved by voice vote two technical amendments (to modify process for allocating allotments to beet refiners (S.Amdt. 2836) offered by Senator Conrad, and authority for 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.