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**SWEETENER INDUSTRY TRADE POLICY ISSUES ON THE HORIZON:
DANGERS, OPPORTUNITIES**

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It is a pleasure to have the opportunity to discuss with you the trade policy challenges facing the U.S. sugar industry.

The U.S. sugar industry is a highly competitive one -- both within the United States market and relative to the world market. Nonetheless, survival among the segments of the U.S. industry is predicated upon their ability to reduce costs of production in the face of flat nominal producer prices for sugar for more than a decade -- prices that are sharply lower when corrected for inflation.

Changes in the structure of our industry the past few years are well known, with growers in some areas exiting the business and others expanding production to increase efficiencies and reduce unit costs. Reforms to U.S. sugar policy in the 1996 Farm Bill, with less government intervention, higher producer risk, and still lower producer prices, both necessitated and facilitated these structural changes.

Meanwhile, our producers have always faced another, external, threat -- that of subsidized foreign sugar from the world dump market. Foreign subsidies are so extensive, and the so-called "world price" for sugar is so distorted, that the world price has averaged less than half the world average cost of producing sugar for most of the past two decades. U.S. production costs are below the world average, but neither the United States, nor any country, can produce sugar for the mere 7 cents per pound the world price has recently been running.

The global movement toward freer trade, thus, raises both opportunities and dangers for U.S. sugar producers.

The major opportunity: Eliminate foreign subsidies that prop up inefficient producers and the world price will rise to reflect the actual cost of producing sugar. American producers could compete head-to-head with foreign producers and there would be no need for a U.S. sugar policy designed to limit imports.

The biggest danger: Unilateral disarmament. If the U.S. reduces its barriers to foreign sugar

before foreign countries dismantle their subsidies, efficient American producers will be displaced by foreign sugar from producers who may not be any more efficient but who are subsidized by their governments.

The opportunities and dangers are manifesting themselves in a growing number of trade policy venues. I'd like to review the major ones from U.S. sugar's point of view; provide some thoughts on the uniqueness of the world sugar market, which trade negotiators must take into account; and outline the U.S. sugar industry's recommendations for future multilateral trade negotiations.

Trade Policy Venues

NAFTA. The U.S. sugar and corn sweetener industry's problems with the North American Free Trade Agreement are considerable.

- * **Sugar Side Letter.** Mexico had been a net importer of sugar for a number of years prior to the inception of the NAFTA in 1994. The governments of both the United States and Mexico predicted Mexico would remain an importer for the foreseeable future. Nonetheless, the NAFTA provided Mexico with more than three times its traditional access to the U.S. sugar market during the first six years, 35 times its traditional access in years 7 - 14, and virtually unlimited access thereafter.

These provisions were negotiated by the U.S. and Mexican governments and contained in President Clinton's NAFTA submission to the U.S. Congress, which Congress approved in November 1993. The sugar provisions, as altered from the original NAFTA text, were critical to the narrow Congressional passage of the NAFTA and were widely publicized in U.S. and Mexican press reports at that time.

Nonetheless, Mexico is now undermining the integrity of the NAFTA by claiming the sugar provisions are somehow invalid. Mexico's attempt to rewrite history on this issue is disingenuous, at best, and appears to be backfiring. Their actions have bred deep feelings of distrust in the integrity of trade agreements among many American producers, and could have profound effects the United States' ability to negotiate future agreements.

The stakes are high in this NAFTA dispute. At issue, basically, is whether the U.S. sugar industry or the Mexican sugar industry bears the cost of the Mexican beverage industry's inevitable conversion from sugar to corn sweeteners. The side letter limits Mexican access to the U.S. sugar market in years 2001-08 to 250,000 tons of its surplus production *excluding* sugar displaced by corn sweeteners. The original NAFTA provisions allowed Mexico to send the U.S. *all* its surplus, *including* sugar displaced by corn sweeteners.

Despite its historic net-importer status, a surge in reported production and some substitution of corn sweeteners for sugar have created a Mexican sugar surplus estimated to be about 1 million tons.

- * **Mexican HFCS Duties.** The NAFTA called for a phase out of Mexican import duties on U.S. high-fructose corn syrup (HFCS). Instead, Mexico has imposed antidumping duties as high as 100% on U.S. HFCS. The United States has requested dispute panels on this issue under both the NAFTA and the World Trade Organization (WTO). Meanwhile, the high duties remain in place.

In addition, the U.S. Trade Representative is reviewing a petition by the U.S. Corn Refiners Association, under section 301 of federal trade law, on an alleged Mexican restraint of trade agreement. Reportedly Mexican bottlers have agreed to limit the pace at which they replace sugar with corn sweetener in beverage production. On this side of the border, a restraint-of-trade agreement of this nature would have U.S. government anti-trust attorneys working furiously toward its removal.

- * **Above-Quota Mexican Sugar.** Under the terms of the Uruguay Round, the U.S. second-tier, or above-quota, raw sugar import tariff has dropped gradually to 15.82 cents per pound this year, bottoming out at 15.36 cents next year. But under the NAFTA, our above-quota duty relative to Mexico is only 13.60 cents this year, and drops gradually to zero in 2008.

In 1994, the year the NAFTA went into effect, the world raw sugar price averaged over 12 cents, and these tariff levels seemed more than adequate to shield the U.S. market from above-quota sugar. Now, however, with the world price plummeting to 7 cents, the tariff on Mexican above-quota sugar may not be enough to prevent Mexico from dumping some world-price sugar on the U.S. market.

Stuffed Molasses. Some Canadian entrepreneurs, and others, have found a way to circumvent the U.S. import quota with a high-sugar content product generally called “stuffed molasses.” USDA estimates the amount of sugar extracted from this product annually to be approaching 100,000 tons. U.S. beet processors and cane refiners have appealed to the U.S. Customs Service to reclassify this molasses so that it becomes a part of the U.S. tariff-rate quota. Customs’ decision has been pending for some time.

A number of foreign countries with shares of the U.S. sugar import quota -- including Australia, the Philippines, and the Caribbean Basin Initiative (CBI) Sugar Group -- have filed statements in support of the U.S. processors’ and refiners’ position. They argue the loophole must be closed because it is not only a threat to U.S. sugar policy but to their own economic well being.

Sunset Reviews. The Uruguay Round called for the removal, or “sunset,” of anti-dumping or countervailing duties by the year 2000 unless reviews by each country revealed the need to keep the duties in place. The U.S. Department of Commerce and the U.S. International Trade Commission are currently reviewing U.S. antidumping duties against sugar and syrups from Canada, France, Belgium, and Germany, and countervailing duties against all sugar from the European Union (EU). The U.S. sugar industry supports their retention. Decisions are expected later this year.

Fast Track. Congress last year rejected legislation to restore to President Clinton his expired “fast-track” authority to negotiate trade agreements that Congress would not be permitted to amend upon consideration. The Administration is committed to regaining fast-track authority, but it remains to be seen whether similar legislation will even be brought up for a vote this year. Administration officials say that regional and multilateral negotiations continue without fast track, but there will come a point when our negotiators’ credibility will be compromised by a lack of fast track authority.

In any event, negotiations do continue on a number of fronts:

NAFTA Accession. Should fast track pass, the most likely first trade agreement vote would be expansion of the NAFTA. First in line is Chile. Since Chile is a significant beet sugar producer - about 400,000 tons per year -- we are watching this closely.

FTAA. Negotiations are underway on the proposed Free Trade Area of the Americas (FTAA), stretching from Canada to Argentina, with the goal of an agreement by 2005.

There are many major sugar exporters in this region. By far the most important is Brazil, where sugar production has exploded in the past few years as alcohol subsidies have dropped. F.O. Licht estimates Brazil’s sugar output this year at 18.8 million tons, up from 16 million last year, and nearly double its production of just five years ago.

Brazil’s dramatic expansion in the face of plummeting world sugar prices underscores two important facts:

- * The world sugar price does *not* reflect the cost of producing sugar, even among the most efficient producers;
- * Changes in production in Brazil, now the world’s biggest single producer, are related more to government decisions about the subsidized price of alcohol than to changes in the world market price of sugar.

The Brazilian government’s “Proalcool” program -- launched during the oil crises of the 1970's -- subsidized the construction of sugarcane milling/distilling facilities to produce fuel

alcohol from sugar and facilitated the expansion of Brazil's cane production from 75 million metric tons in 1975 to 280 million tons last year. More than half that cane goes to fuel alcohol production. The effects of this long-term, massive subsidy program must be taken into account in any future regional or multilateral trade negotiations with Brazil.

WTO. The World Trade Organization replaced the General Agreement on Tariffs and Trade (GATT) as the forum for multilateral trade negotiations in 1995. The final year of the Uruguay Round of trade barrier reductions is 2000.

The United States will host a Ministerial in Seattle in November to discuss the possible launch of another multilateral trade round to continue trade liberalization beyond the Uruguay Round. All of U.S. agriculture has much at stake. Unilateral concessions made in the 1996 Farm Bill far exceeded our Uruguay Round commitments and have made U.S. agriculture more vulnerable to the continued use of subsidies by other countries. Future negotiations must be performed carefully to prevent the U.S. from becoming even more disadvantaged.

For example, in the next trade round, access to developed countries should be conditioned on developing countries' achievement *and enforcement* of higher labor and environmental standards. Such an incentive system could help ensure that the next trade round results in a race to the top, in protection of workers and the environment, rather than a race to the bottom. We have publicly supported the remarks President Clinton made in this regard last May at the WTO in Geneva.

Another concern is the Uruguay Round's formula-based approach, which called for across-the-board percentage reductions, regardless of the original level of price support, import barrier, or export subsidy. Countries with the most egregious barriers have maintained their advantage throughout the transition process. For example, if one country's price support were 40% higher than another's, and both reduced by the URA-mandated 20%, the 40% advantage would remain in place -- the playing field has been *lowered*, but not *leveled*. This rigid approach needs to be replaced with a more flexible, pragmatic one.

OECD. The Organization for Economic Cooperation and Development (OECD), based in Paris, is comprised of the world's most developed countries, and is dedicated to fostering economic progress in the developing world. The OECD supplied key market data and policy analysis for Uruguay Round negotiators and is expected to do the same for the WTO.

The OECD's work on global sugar policy has been problematic in the past and warrants close monitoring by the U.S. government and sugar industry.

APEC. The Asian Pacific Economic Cooperation (APEC) talks have begun, with the aim a huge Pacific Rim free trade area by 2010. Australia, one of the world's top sugar exporters,

will be a major player in these negotiations and has already begun surfacing sugar policies as a topic for discussion.

The Unique Characteristics of the World Sugar Market

There are a number of unique characteristics to the world sugar market, which trade negotiators must take into account in future multilateral deliberations.

World Dump Market. More than 100 countries produce sugar and the governments of all these countries intervene in their sugar markets and industries in some way. These unfair trading practices have led to the distortion in the so-called “world market” for sugar, and to a disconnect between the cost of production and prices on the world sugar market, more aptly called a “dump market.” Indeed, for the period of 1984/85 through 1994/95, the most recent period for which cost of production data are available, the world average cost of producing sugar is over 18 cents, while the world dump market price averaged barely *half* that -- just a little more than 9 cents per pound raw value. (See chart, Attachment A.)

Volatility. Furthermore, its dump nature makes sugar the world’s most volatile commodity market. Because it is a relatively thinly traded market, small shifts in supply or demand can cause huge changes in price.

During the period 1965-95, the average deviation from trend for raw sugar prices was nearly 50 percent, more than double the average deviation for corn and almost double that of wheat. Just in the past two decades, world sugar prices have soared above 60 cents per pound and plummeted below 3 cents per pound.

Other Factors. Aside from the highly residual and volatile nature of the world sugar price, there are a number of factors that set sugar apart from other program commodities. These unique characteristics should be taken into account before sugar is lumped in with other commodities for across-the-board policy reforms.

* **Lack of Concentration.** World grain exports are overwhelmingly dominated by a small number of developed countries, but sugar exports are far more dispersed, and dominated by developing countries. This makes the playing field among major grain exporters comparatively level and policy reform relatively less complicated than for sugar.

The world wheat and corn markets, for example, are heavily dominated by a handful of developed-country exporters -- the United States, the European Union, Australia, and Canada are four of the top five exporters of each. The top five account for 96% of global corn exports and 91% of wheat exports.

The top five sugar exporting countries, on the other hand, account for only two-thirds of global exports and three of these are developing countries. The top 19 sugar exporters account for only 85% of the market, and 16 of these are developing countries. (See charts, Attachments B & C.)

- * **Developing Country Dominance.** Developing countries account for 73% of world sugar production, and 69% of both exports and imports. Developing countries were virtually ignored in the Uruguay Round of reductions in barriers to agricultural trade, and impose far lower costs on their producers for labor and environmental protections. (See charts, Attachments D - F)
- * **Grower/Processor Interdependence.** Grain, oilseed, and most other field-crop farmers harvest a product that can be sold for commercial use or stored without any further processing. Sugarbeet and sugarcane farmers harvest a product that is highly perishable and of *no commercial value* until the sugar has been extracted. Farmers cannot, therefore, grow beets or cane unless they either own, or have contracted with, a processing plant. Likewise, processors cannot function economically unless they have an optimal supply of beets or cane. This interdependence leaves the sugar industry far less flexible in responding to changes in the price of sugar or of competing crops.
- * **Multi-Year Investment.** The multimillion-dollar cost of constructing a beet or cane processing plant (approximately \$300 million), the need for planting, cultivating, and harvesting machinery that is unique to sugar, and the practice of extracting several harvests from one planting of sugarcane, make beet or cane planting an expensive, multiyear investment. These huge, long-term investments further reduce the sugar industry's ability to make short-term adjustments to sudden economic changes.
- * **High-Value Product.** While the *gross* returns per acre of beets or cane tend to be significantly higher than for other crops, critics often ignore the high cost associated with growing these crops. Compared with growing wheat, for example, USDA statistics reveal the *total economic cost* of growing cane is nearly seven times higher, and beet is more than five times higher. With the additional cost for processing the beets and cane, sugar is really more of a high-value product than a field crop.

Inability to Hedge. The 1996 Freedom to Farm Bill made American farmers far more dependent on the marketplace. Growers of grains, oilseeds, cotton, and rice can reduce their vulnerability to market swings by hedging or forward contracting on a variety of futures markets for their commodities. There is *no* futures market for beets or cane. Farmers do not market their crop and can neither make, nor take, delivery of beet or cane sugar. The hedging or forward contracting opportunities exist only for the processors -- the sellers of the sugar derived from the beets and cane. These

marketing limitations make beet and cane farmers more vulnerable than other farmers to market swings.

U.S. Sugar Industry's Trade Policy Recommendations

Shaped by our experience and by the specific failures of past agreements, the following are the ASA's recommendations for future trade negotiations:

1. Compliance with past agreements, in particular, the Uruguay Round Agreement of the WTO and the North American Free Trade Agreement, must be achieved before the United States forges any new agreements. The United States, and any other country that has surpassed its URA commitments, should be given credit for doing so before being required to make further cuts in the next trade round.
2. The United States must not reduce its support for agricultural programs, particularly for import-sensitive crops such as sugar, any further until other countries have reduced their support to our level.
3. Elimination of export subsidies, the most trade distorting of all practices, and of state trading enterprises (STE's), which were ignored previously, must be given top priority in the next trade round.
4. The wide gap in labor and environmental standards between developed and developing countries must be taken into account in the next trade round, to provide both incentives and penalties that ensure global standards rise to developed-country levels, rather than fall to developing-country levels.
5. A flexible, request/offer type of strategy must be followed in the next trade round, rather than a rigid, across-the-board, formula approach. Only in this manner can we address the huge disparities in supports among nations and turn the United States' unilateral concessions to our advantage. We must provide foreign countries the incentive to reduce their government programs by promising to reduce ours further when, and only when, they have reduced their export subsidies, internal support, import tariffs, and STE or similar practices to our levels.