Sugar Policy

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Introduction

The FAIR Act of 1996 continued support of U.S. sugar by means of a loan rate in addition to the use of import restrictions. The loan rate is differentiated with respect to the type of sugar produced: the loan rate for sugar cane is 18¢/lb of raw cane sugar while the loan rate for sugar beets is 22.9¢/lb of refined beet sugar.

Loans may be recourse or nonrecourse, depending on the tariff-rate quota (TRQ) level determined by the Secretary of Agriculture (or USDA). If the TRQ is less than 1.5 million short tons, loans become recourse loans. In this case, the loans must be repaid regardless of the price of sugar. However, if the TRQ for a specific year is greater than 1.5 million short tons, the loans are nonrecourse. In this case, as the price of sugar falls below the loan rate, sugar used as loan collateral may be forfeited as payment in full for any debt under the loan program.

The penalty for loan forfeiture under a nonrecourse loan is 1¢/lb. The nonrecourse loan establishes an effective price floor of 17.0¢/lb for raw cane sugar and 21.0¢/lb for refined beet sugar.

Additional provisions of the 1996 FAIR Act serve to alter the environment of the U.S. sugar industry. Among these, provisions establishing marketing controls on sugar and crystalline fructose have been suspended. This serves to allow for the determination of sugar or crystalline fructose production based on market forces and competitiveness-related factors rather than marketing quotas.

In addition to the removal of domestic marketing controls, the current farm legislation increased the marketing assessment from 0.20¢/lb to 0.25¢/lb. While this increase may mitigate a portion of the effect resulting from removal of domestic marketing controls, it also serves to increase government revenue. Increased marketing assessments partially offset the costs of potentially large government expenditures resulting from a nonrecourse loan program.

Current Situation

Until quite recently, the U.S. sugar program has operated at no budget cost to the federal government. However, nonrecourse loan forfeitures, combined with downward pressure on domestic prices through market access through NAFTA and the WTO, raise the potential for large future outlays to support domestic sugar at current support levels.

A TRQ of greater than 1.5 million short tons has been in place for both the 2000 and 2001 marketing years. This has resulted in conditions necessary to implement commodity loans as nonrecourse.

A Payment-in-Kind (PIK) program was implemented in August 2000. This came about as the result of 1) government owned stocks, and 2) desire by government to avoid future forfeitures of sugar under the nonrecourse loan program. Implementation of PIK takes the sugar program one step closer to the possibility of direct government support, which could be implemented through means such as deficiency payments or other decoupled support.

Sugar policy affects producers, processors, rural communities, exporters, consumers, and taxpayers.

Issues

Impacts of the current sugar policy include: 1) a high but stable domestic sugar price; 2) reduced U.S. sugar consumption; 3) increased corn sweetener consumption; and 4) a lower but more volatile world sugar price than would exist under greater market orientation. More resources are employed in the production and processing of sugar and corn sweetener industries than under the scenario of greater market access. Additional issues include the following:

- At what level, if any, should the sugar industry be supported, and how should such support be implemented?
- Should the market price be decoupled from domestic support, allowing the domestic market to clear?
- Should direct payments be initiated? If direct payments are implemented, how should they be paid to integrated producer-processors given the deficiency payment limitations for other crops?
- Is there a role for government involvement in stockholding or other types of governmental market intervention?
- Should government compensation be provided to communities and agribusiness firms that are adversely impacted by the modification of sugar policies?
- What policy options will eliminate the tendency toward over-production on the part of domestic and foreign producers?
- How should U.S. sugar policy evolve given the increased market access provided through the North American Free Trade Agreement and the World Trade Organization?
- If trade restrictions against Cuba are eased, should Cuba be granted a sugar quota? If so, how much?

Policy Alternatives and Consequences

The domestic price of sugar continues to face downward pressure as long as it is supported above the world market price. This becomes especially critical due to increased market access resulting from NAFTA, the possibility for further increases through the WTO, and the potential resumption of trade with Cuba. Given this new environment, supporting the sugar sector at current levels while operating the sugar program at no budget cost to the federal government becomes an impossibility.

This dilemma highlights the importance of developing and adopting new and creative policy alternatives to address the concerns of various interest groups, and is especially true as the U.S. enters an era in which its ability to provide domestic support through trade restrictions becomes increasingly limited. The following scenarios and policy tools are not intended to be mutually exclusive. Rather, policy-makers may consider various combinations of the following in developing an efficient domestic sugar program that is fiscally prudent yet provides adequate support to sugar producers.

Status Quo

One obvious option for the domestic sugar program involves retention of the status quo. Several factors have combined to make this alternative appear to be politically infeasible. Increased market access provided through various trade agreements has shifted the burden of U.S. price supports from domestic consumers and foreign producers to the U.S. government. As the tariff-rate-quota expands, downward pressure on the domestic price will cause increased forfeiture under the nonrecourse loan program. In turn, this will increase the burden on U.S. taxpayers — an option that may not be feasible in the long run.

Marketing Loans

Marketing loans are another tool that can be used to support the price received by domestic producers. Ideally, this policy instrument can result in price guarantees to producers while consumers pay the price dictated by the market. With this type of program, the government bears the cost of supporting producer incomes.

In addition to the producer and consumer welfare gains suggested above, this option has another advantage. Current policy instruments support the domestic sugar price at levels above the world price. This inflated domestic price gives foreign producers added incentive to export sugar into the U.S. market. From the perspective of foreign producers, decoupling the U.S. market price from the support level would decrease the relative profitability in the U.S. market. In turn, this would diminish the incentive for foreign sugar imports.

A question, however, must be raised concerning the long-term viability of this type of policy. Marketing loans influence production decisions. As such, they are classified as trade distorting policies. Assuming that these types of policies will eventually be phased out under the WTO agreement, marketing loans may be viewed as a transitional instrument to be used in the short to intermediate-term.

Fixed Direct Payment

An alternative to marketing loans, fixed direct payments, provide compensation based on historical production levels. Given that these payments are not linked to current production levels, they are consistent with the WTO "Green Box" criteria and, as such, are WTO-legal.

Similar to marketing loans, this policy instrument decouples producer support from the domestic market price. As a result, artificial incentives for foreign sugar to be imported into the U.S. market are removed. At the same time, U.S. production decisions will be based on the market as opposed to price support levels.

One of the difficulties in implementing this type of policy instrument is determining the fixed payment level. Knowing the support level the instrument is designed to achieve will help determine the payment level. However, the desired level of support is an elusive target, given fluctuations in market prices and the production effects of adopting fixed payments.

Fixed Direct Payment and Decreased Marketing Loan Rate

A combination of the fixed direct payment and marketing loan rate options may alleviate many of the uncertainties mentioned above. Scenarios of this nature would serve to partially decouple government support from production decisions. At the same time, the lowered loan-rate would continue to act as a safety net for producers. For example, Orden (2000) suggested a "25/50" proposal. Under this scenario, loan rates would be reduced by 25 percent. Fixed payments would be provided in the amount of 50 percent of the change in the loan rate, based on some historical production. Various deviations from this scenario can be developed with differing levels of government expenditure and support levels.

Payment-in-Kind (PIK) Program

In June 2000, the U.S. government entered the sugar market for the first time in 14 years, purchasing 132,000 tons of refined sugar. In August 2000, the U.S. government initiated a sugar payment-in-kind

(PIK) program in which sugarbeet producers were given the option of diverting acreage from sugar production in exchange for sugar. These actions served to support the domestic price by 1) taking sugar off the market, and 2) diverting acreage from sugar production, thereby decreasing supply. By doing so, the likelihood of nonrecourse loan forfeiture would be reduced, saving the government approximately six million dollars (Haley and Suarez, 2000).

Given current use of nonrecourse loans as a policy tool, the PIK program serves a useful role of supporting domestic prices and averting widespread loan forfeitures. It can be a useful tool in this sense. However, due to their relatively large transaction cost, PIK programs may not be as cost effective as other forms of producer support. Other programs, such as direct payments, do not involve the transfer of ownership. As a result, producer support per dollar of government expenditure will tend to be lower under a PIK program than that provided with direct payments.

Sugar "Buy-Out" Program

Current sugar support levels have, to an extent, become institutionalized from the perspective of sugar producers as well as ancillary industries and communities. An example of this can be seen in the valuation of sugar-producing land. Artificially supported prices tend to be capitalized into the value of the land. If government support were to be eliminated, producers could suffer a decrease in the value of their land. This would be especially detrimental to those producers entering the industry following the implementation of government support. If land values decline, repercussions would also be felt in the agricultural lending industry.

One option to effectively deal with this situation involves the implementation of a sugar "buy-out" program. Producers could be compensated with a lump-sum equal to the net present value of some stream of future support. In turn, sugar support levels would be reduced or eliminated. The resulting market-oriented environment would cause production and consumption decisions to be influenced by the market. At the same time, the artificial incentive for foreign producers to enter the U.S. market would be eliminated.

Elimination of Domestic Support and Import Restrictions (Free Trade)

An additional policy option is the complete elimination of domestic support and import restrictions. Adoption of this scenario has clear advantages and disadvantages. On the positive side, U.S. consumers will benefit through lower sugar prices as dictated by the market. In addition, taxpayers will not bear the cost of supporting the sugar industry. On the other hand, groups such as sugar producers, ancillary industries, and rural communities would be adversely impacted by the immediate and complete elimination of domestic support and import restrictions.

While the merits of such an action continue to be debated, an important issue concerns the transition plan to be implemented if such a plan were adopted. As mentioned earlier, an immediate elimination of sugar support would be quite traumatic to producers, some agribusinesses, and sugar dependent rural communities. If such a plan were to be seriously considered, it could include means to compensate stakeholders adversely impacted by the policy-change. For example, transition payments in the form of community development assistance would allow rural communities to attract and develop industries to replace jobs and revenue lost as a result of the sugar support removal.

References and Suggested Readings

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