STATEMENT OF THOMAS EARLEY

Madam Chair and members of the Commission, it's an honor to appear before you on behalf of the Sweetener Users Association, which represents companies in confectionery, dairy products, soft drinks, grocery manufacturing and other industries. My name is Tom Earley and I'm a Vice President of Promar International, an economic consulting firm specializing in food and agriculture. I'm here today in my role as economist for the Association.

Since SUA last testified before the Commission on this question during its 2008 investigation, there have been a number of developments affecting sweetener trade that should be of particular interest to the Commission.

- First, as we feared, the implementation of the provisions of the 2008 farm bill has increased the adverse impacts of sugar import restraints on sugar consumers and users.
- Second, while the evolving integration of the U.S. and Mexican sweetener markets has been mostly beneficial, Mexico maintains import barriers for other countries comparable to those imposed by the United States, so the integration does not change the protected nature of the overall market.
- Third, one positive development has been the addition to the U.S. Harmonized Tariff Schedules of a separate tariff line for high quality refined sugar. We are thankful that U.S. government agencies, including the Commission, tackled this issue.
- Finally, U.S. sugar producers have continued to make efforts to achieve some form of managed trade with Mexico in order to roll back the full liberalization under NAFTA that finally occurred in 2008.

All of these developments tend to highlight the increasingly anachronistic character of the U.S. sugar price support program and associated import barriers.

Impact of 2008 Farm Bill Changes

The 2008 farm bill included four main changes to the sugar program. First, sugar loan rates for raw cane sugar and refined beet sugar were increased.

Second, the legislation made changes in the marketing allotment provisions, establishing a permanent Overall Allotment Quantity (OAQ) that cannot be less than 85% of estimated consumption.

Third, the farm bill mandates that USDA acquire any surplus and sell it to producers of fuel ethanol or other forms of bioenergy if necessary to prevent sugar loan forfeitures.

Finally, and most importantly, the 2008 farm bill imposed new restrictions on the Secretary of Agriculture's authority to establish and adjust sugar import quotas to meet domestic needs. Specifically, the farm bill requires the Secretary of Agriculture to initially set the sugar import quotas (except for specialty sugars) each year at the minimum required to comply with international trade agreements. At the beginning of the quota year, TRQs for raw and refined sugar are to be established at the WTO minimums, which are about 1.2 million short tons (raw value) and 24,000 short tons (raw value) respectively.

These TRQs cannot be increased until the second half of the October-September marketing year, unless there is an "emergency shortage," which to date has been narrowly defined by the Secretary of Agriculture. This has proven to be the most damaging new provision in terms of further restricting the available supply of sugar in the U.S. market. In fact, the U.S. now consumes nearly 11 million tons of sugar per year, but only produces about 8 million, which leaves an import requirement in the range of 3 million tons. Going through half the year with import quotas at less than half that amount creates serious distortions in the market, particularly since about half the quota-holding countries no longer ship any sugar to the United States.

Market Developments provide Clear Evidence of Sugar Program Failure

During 2010, U.S. wholesale and retail sugar prices rose to record highs. This has been due partly to a rise in world market sugar prices, partly due to the more restrictive import quotas resulting from the changes in the 2008 farm bill, and partly due to USDA reluctance to make adequate quantities of foreign sugar available to the marketplace. These factors have made for a lethal combination for anyone in the U.S. needing to buy sugar.

World sugar prices began to creep up in 2009 due to production shortfalls in a number of countries. After peaking in February 2010, they fell back to about 15 cents but began to rise again as it became apparent that sugarcane crops in Brazil, India, Australia, Thailand and other countries were being adversely affected by the La Niña weather phenomenon, erasing the prospect of any rebuilding of world sugar stocks in 2010/11.

U.S. raw sugar prices followed the world price, but with a differential roughly equal to the high second tier duties under our tariff-rate quota. Those duties are roughly 15 cents/pound for raw sugar and 16 cents/pound for refined sugar. These duties are normally prohibitive, because that is their purpose. But that did not prove to be the case in 2010.

Throughout the course of the 2009/10 marketing year, it was clear that the U.S. market was short of sugar. In early 2010, the Sweetener Users Association told USDA that import quotas needed to be increased by at least one million tons to meet market needs, but USDA officials were reluctant to go that far. By July they had increased the raw sugar TRQ by only 500,000 tons, and USTR made some additional sugar available by reallocating quota shortfalls.

But the dire need for additional sugar supplies forced end users to resort to extraordinary measures to get more sugar. They made more use of the sugar re-export program. They bought additional sugar from Mexico at high prices. And they actually paid what is designed to be a prohibitive second-tier duty of about 16 cents on 200,000 tons to get over-quota sugar into the country. In our minds that is a clear sign of program failure. Moreover, it deprives quota-holding countries of their rights negotiated during the Uruguay Round, because the proper alternative would have been an increase in the TRQ that would have permitted the quota holders to receive the benefit of the higher protected U.S. price.

Sugar Producer/Processor Efforts to Further Restrain Imports

U.S. sugar beet and sugarcane growers and processors have made numerous attempts in recent years to control sweetener trade between Mexico and the United States. These efforts have rightfully been rejected by Congress, the Administration and the Mexican government, especially since such measures would also jeopardize free trade in other agricultural commodities as provided under NAFTA.

In the latest instance of attempting to reintroduce some form of managed trade, the sugar industries of the two countries petitioned both governments in October 2009 for creation of a joint government sugar commission, introduction of measures that would give each government a say in the other government's sugar import decisions, and elimination of the U.S. refined sugar re-export program and Mexico's similar IMMEX program.

Fortunately, the two governments issued a joint letter earlier this year turning down the key parts of the request, recognizing that they would only open the door to requests from other import sensitive sectors in each country for introduction of new restrictions on trade. It will not be surprising if the U.S. sugar industry makes another try at restricting U.S.-Mexico sweetener trade in the next farm bill.

Needs of Sugar Users

Users of sugar need a reliable, affordable supply of high-quality sugar to make the broad range of products that they manufacture. As noted above, we need access to a large volume of imports because the United States does not produce enough sugar to meet all market needs.

Among present U.S. sugar policies, the tariff rate quotas are of course the most relevant to the Commission's present investigation. While the following comments focus primarily on the TRQs rather than on other elements of sugar policy, such as price supports and marketing controls, the Commission should understand that all elements of current sugar policy are closely related. All are in need of reform and all affect import access to the U.S. market.

Welfare Losses and the Sugar TRQ

All independent analyses of the U.S. sugar TRQ have concluded that it constitutes a net cost to society and creates a large transfer of income from consumers to sugar producers. A June 2000 study by the General Accounting Office estimated that Americans paid an extra $1.9 billion a year for sugar due to the sugar program. Generally, these analyses have compared the price of raw sugar in the protected U.S. market to the world price of raw sugar. The resulting price gap has been the usual basis for quantifying the costs of U.S. sugar policies (as well as their benefits to U.S. producers).

The existing analyses generally deal with a market situation in which there is a large gap between U.S. and world raw sugar prices. Certainly that has been the rule rather than the exception in recent decades. From 1990-2005, the world price of raw sugar as reported by USDA averaged 9.4 cents per pound, and the U.S. price of raw sugar averaged 21.5 cents per pound. Adding 2 cents to the world price to get to a delivered U.S. basis yields an average gap of about 10 cents per pound or $200 per ton over the 16 years. On 11 million tons of consumption that is about $2.2 billion.

In 2006 and again in 2009, the world price of sugar rallied strongly, averaging 13.6 cents over the four-year period and closing a third of the gap with U.S. prices that averaged 22.3 cents over the four years. The world price rally was partly the result of transient weather factors and partly fueled by factors that may be secular rather than cyclical. These included the incentives to devote a greater portion of the world sugarcane crop to ethanol production, especially in Brazil, because of rising petroleum prices, and far-ranging changes in European Union sugar policy that have eliminated that bloc's large net export position in world sugar trade.

The current year brought a much tighter world sugar supply situation and world raw sugar prices will have averaged over 22 cents per pound by the time 2010 is over, about equivalent to the effective U.S. support level. Based on historical market performance, the U.S. raw sugar price would have only been two or three cents above that figure if the government had announced an adequate import quota. However, this year the U.S. raw sugar price will have averaged 36 cents per pound, which is almost 14 cents above the average world price. Because the U.S. market has not had adequate supplies for most of the year, the price was forced up to such a high level for much of the year that importers had no other choice than paying the prohibitive duty to buy over-quota sugar to meet their needs.

The disequilibrium has been even greater for refined sugar. As shown in Chart 2 at the end of our pre-hearing submission, the differential between U.S. and world market refined sugar prices was 25-35 cents per pound for most of the year. **Even taking the bottom end of that range, i.e. 25 cents, that is an implied cost to consumers of over $5 billion on the 10.2 million tons of refined sugar the U.S. used last year.**

SUA therefore recommends that USITC staff study not only the raw sugar price gap, but also the refined sugar price gap. After all, consumers and industrial users buy refined sugar, not raw sugar. The manner in which sugar import restraints now operate, coupled with current industry structure, is resulting in an even wider gap between world market and domestic refined sugar prices. SUA believes U.S. sugar import policies must be modified so that they are more responsive to market needs and strike a fairer balance between the interests of producers and consumers.

Country Quotas are Increasingly Anachronistic

The U.S. raw sugar TRQ is allocated among some 40 countries. Consistent with GATT requirements that import quotas be assigned on the basis of a "previous representative period," the quota allocations are based on market shares of the countries during 1975-1981, when sugar trade was largely unrestricted. Such an allocation undoubtedly made sense in the early-to-mid 1980s, when U.S. sugar policies took their present form.

However, it is much less clear that the current allocations are rational as we enter the second decade of the 21st century, almost 30 years after the quota scheme was created. In that period, world production and trade patterns have shifted considerably, while quota-holding countries' shares of the TRQ have remained largely unchanged.

The result is that some countries eligible to export quota sugar to the United States are themselves net importers – meaning they have to import sugar from the world market to satisfy domestic needs, if they want to earn foreign exchange by shipping their domestically-produced sugar to the more lucrative U.S. market. This is hardly a model of economic efficiency.

Other countries apparently have production costs so high that even the prospect of gaining the high internal U.S. market price is an insufficient incentive – they routinely fail to ship their quotas, exacerbating the normal shortfall in filling the entire U.S. TRQ. About half the quota holders sent no sugar to the United States in 2009/10.

During the 1980s and 1990s, only a small percentage of the raw sugar TRQ went unfilled. In most years, the shortfall was only around 50,000 tons out of the more than 1.1 million ton minimum TRQ. But over the last few years, shortfalls have risen steadily, reaching almost 200,000 metric tons in 2008/09. Even with two rounds of quota reallocations, shortfalls in 2009/10 were still almost 100,000 metric tons.

Conclusion

The United States needs a market-based and efficient sugar policy. The present sugar TRQ system falls short of those criteria. That need not imply the abandonment of the TRQ structure completely, but it certainly suggests the urgent need for significant improvements in the way it is administered.

The integration of the U.S. and Mexican sweetener markets, with large volumes of HFCS flowing south and large volumes of sugar flowing north, alters the dynamics to some degree, but the combined market will continue to be a major net importer of sugar. This means that the two governments will continue to be able to use sugar TRQs to limit supply and support market prices, transferring large amounts of income from sugar consumers to sugar producers, and reducing total economic welfare.

For purposes of the Commission's present investigation, SUA again urges a thorough study of not only the raw sugar price gap maintained by the TRQs, which is no longer their most onerous feature, but also the refined sugar price gap. In addition, SUA encourages the Commission to identify the distortions and perverse incentives that are inherent in the current TRQ structure, and to assess the adverse impacts that import quotas are having on employment in food and beverage manufacturing. In so doing, the Commission will perform a notable service to Congress, the sugar industry and the public.

SUA thanks the Commission for the opportunity to express these views.