Sweet or Sour?

The U.S. Sugar Program and the Threats Posed by the Dominican Republic-Central America Free Trade Agreement

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ABOUT IATP

The Institute for Agriculture and Trade Policy promotes resilient family farms, rural communities and ecosystems around the world through research and education, science and technology, and advocacy.

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ABOUT THIS PUBLICATION

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Executive summary

The Bush Administration has negotiated the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA) with six other countries: the Dominican Republic, Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua. Although legislatures in El Salvador, Honduras and Nicaragua have ratified the agreement, strong popular opposition in the United States and in the other participating countries continues to keep the ultimate approval of the pact in doubt. Many advocates of the current "free trade" model view the approval of DR-CAFTA as crucial to regaining momentum for the stalled negotiations over the Free Trade Area of the Americas (FTAA) and at the World Trade Organization (WTO).

Domestically, opposition has risen to the current free trade model epitomized by DR-CAFTA for several reasons. The U.S. trade deficit has soared to record levels, threatening to undermine economic growth. The promises made in the 1990s that the North American Free Trade Agreement (NAFTA) is the best trade model to bring overall economic prosperity haven't materialized. Internationally, opposition to the current trade model is increasing because of the perceived hypocrisy of rich countries demanding that developing countries dismantle their border protections and slash domestic support programs while rich countries spend billions of dollars per year in direct government subsidies to buffer their own agricultural sectors from devastatingly low world commodity prices.

U.S. agriculture and trade policy is at a unique historical moment. The U.S. budget crisis has caused President Bush and lawmakers to target U.S. agriculture programs for cuts in order to help reduce the ballooning budget deficit. At the same time, Brazil has led successful challenges at the WTO against both U.S. cotton subsidies and EU sugar subsidies. These WTO decisions have substantially increased the political pressure to reduce government agricultural subsidies in developed countries. It's time to look for an alternative vision for agriculture—both in the U.S. and around the world.

The U.S. sugar program provides us with such a starting point for rethinking U.S. agricultural trade policy. It is the only major U.S. agricultural commodity program that operates at no cost to taxpayers and prevents U.S. export dumping onto world markets at below the cost of production. It accomplishes these goals by matching sugar supplies with demand, which results in fair prices for farmers at no cost to taxpayers. The sugar program is the antithesis to the other U.S. commodity programs, which are the root cause of costly and unsustainable overproduction, low prices and unjust dumping of agricultural commodities onto world markets. Unfortunately, DR-CAFTA threatens to destroy the careful balance of supply and demand achieved through the current U.S. sugar program.

Major findings

DR-CAFTA would likely cause major disruptions to the U.S. sugar program. The Bush Administration likens DR-CAFTA to a "teaspoon of sugar," noting that it would increase sugar imports by less than 2 percent of domestic consumption. But the administration's assessment ignores several factors. Mexico will have the right to import unlimited amounts of sugar into the U.S. under NAFTA starting in 2008. The USTR refuses to take sugar off the negotiating table in several pending trade agreements that include major sugar-producing countries. Approval of any of these pending agreements could bring substantial amounts of additional sugar into the U.S. domestic market. Finally, even the small increase

in sugar imports in DR-CAFTA, when combined with additional exports from Mexico under NAFTA, could exceed a congressionally mandated "trigger level" of 1.39 million metric tons—which is essential to the maintenance of the sugar program.

DR-CAFTA could turn sugar's no-cost program into a big bill for taxpayers. If the trigger level is exceeded, the 2002 Farm Bill contains language that would suspend the authority of the Secretary of Agriculture to manage domestic production through marketing allocations. Suspension of marketing allocations would not only result in domestic overproduction, but also in the release of substantial amounts of sugar reserves onto the domestic market. This flood of sugar would dramatically depress sugar prices to the point where the sugar program would be transformed from a no-cost program to just one more expensive commodity program. If sugar imports exceed 2 million metric tons—through likely increases caused by a combination of DR-CAFTA, NAFTA and other pending trade agreements—a North Dakota State University economic study projects that the U.S. would lose over 80 percent of its sugar production, including the loss of all of its sugar beet production.

DR-CAFTA would likely cause a price drop for sugar farmers in the U.S. and many developing countries. DR-CAFTA would jeopardize current congressional mandates that ensure U.S. farmers participating in the sugar program receive a fair price from the market place. Such a development could reduce the supported domestic price now received by the 41 countries that export sugar to the U.S. The agreement also raises the likelihood of deregulation of the U.S. sugar market and would therefore threaten access to the lucrative U.S. sugar market for some of the world's poorest developing countries, some of which are disproportionately dependent on sugar export revenues.

DR-CAFTA could turn sugar into a dumped commodity on international markets. Unlike other major U.S. commodity programs, the sugar program actually prevents dumping on the world market at below the cost of production. Preventing dumping is especially important for developing-country farmers whose governments are being pressured at the WTO to open their borders to dumped agricultural commodities. Unlike rich countries, poor countries cannot afford to make large direct-subsidy payments to buffer their farmers from the devastatingly low world market prices for agricultural commodities caused by dumping. Additionally, the "sugar compensation mechanism" in the DR-CAFTA text poses the unacceptable threat of transforming the U.S. sugar program from a non-dumping program into a dumping program. Dumping of sugar and all other commodities should be banned worldwide, and mechanisms should be created to enforce such bans. Until dumping is banned, all countries should retain the right to protect their borders from imported agricultural commodities dumped below cost onto world markets.

The potential demise of the U.S. sugar program raises many important and, as of yet, unanswered questions: Which crops would farmers plant as sugar prices fall? Would the shift of abandoned sugar acreage to other crops cause the prices for the substitute crops to fall? Would increased production of other crops from abandoned sugar acreages exacerbate the dumping of these crops onto world markets? If sugar acreage were abandoned for other crops, how much in additional government subsidies would be needed to support those substitute crops? What would be the impacts on the revenues currently received by the 41 countries that now export sugar to the United States? These and other questions must be addressed before Congress votes on DR-CAFTA.

For decades now, the U.S. sugar program has offered a sound policy model that has successfully created market stability at little public expense while avoiding the structural overproduction that leads to dumping onto international markets. Before we abandon this sound policy, we should ask whether sugar producers around the world would be better off by allowing DR-CAFTA to be the first step towards destroying this program and replacing it with some mutated version of the other failed U.S. commodity programs that are becoming less defensible by the day. Or should we look to the U.S. sugar program and other supply-management programs around the world for lessons on how to solve the current global commodity crisis?

Moving toward a more just agricultural and trade policy: Policy recommendations

1. Reject DR-CAFTA. This agreement would lead to the destruction of all the positive benefits of the U.S. sugar program including fair prices, no taxpayer expense and no export dumping on world markets. In addition, it would likely reduce income from most small developing countries that are currently exporting sugar into the United States.

2. Pursue multilateral negotiations. Neither sugar nor any other globally traded agricultural commodity should be negotiated in a piecemeal fashion in regional trade pacts like DR-CAFTA. Ideally, all agricultural commodities should be negotiated simultaneously, comprehensively and multilaterally. Such an approach would allow for adequate consideration to be given to the complicated and often subtle interrelationships among commodities, e.g., the relationship between sugar and high fructose corn syrup or the relationship between the cost of feed grains and livestock prices. At a minimum, no agricultural commodity should be negotiated in any trade agreement without the inclusion of all countries that are major exporters of a particular commodity—especially if any exporters are guilty of dumping (see Appendix B).

3. Make development a priority through preferential market access. Interested parties should review the current decision-making process for establishing TRQs for the U.S. sugar program. Such an effort could identify and develop new criteria for prioritizing TRQs to maximize development opportunities in poor countries based on the greatest need, e.g., the per capita income of the country or whether sugar is the sole commodity that is economically viable to export. Interested parties should consult with fair trade partners in both the U.S. and the global South to explore ways to improve labor, environmental and human rights in the sugar industry in all countries—including the United States. These consultations should explore the feasibility of developing additional criteria (e.g. environmentally sound farming practices or compliance with International Labor Organization standards) for obtaining U.S. sugar TRQs that could support legitimate reform efforts in sugar-producing countries.

4. Examine the U.S. sugar program as a domestic model. Interested parties should explore the possibility of putting a reformed U.S. sugar program forth as an alternative model for other commodities as pressure builds domestically to cut subsidies. As the debate heats up over the 2007 U.S. Farm Bill, consideration should be given to using the U.S. sugar program as a viable domestic model for cutting government payments, ending export dumping and providing more equitable market access to developing countries.

5. Examine the U.S. sugar program as an international model. Interested parties should explore the possibility of establishing an international commodity agreement for sugar that could be modeled on previ-

ous commodity agreements such as the International Coffee Agreement. Such an initiative could potentially raise the price of sugar in the world market to improve the livelihoods of sugar producers around the world. If successful, such an endeavor could provide a model for future agreements in other commodities.

6. Ban dumping of agricultural commodities onto world markets. All countries should take immediate steps to prevent agricultural exports from being dumped onto world agricultural markets at below the cost of production. Additionally, immediate steps should be taken to develop and implement international rules and programs to end dumping worldwide.

7. Countries should defend themselves against dumping. Until dumping is effectively curtailed worldwide, all countries should retain and exercise their sovereign right to prevent the dumping of any agricultural commodity into their domestic market at below the cost of production through tariff rate quotas, countervailing duties or other border controls. Without an effective total worldwide prohibition on dumping, complete deregulation of borders makes it impossible for countries to maintain effective supply management programs, which paradoxically represent one of the most effective policies for ending dumping.

8. Forge an agreement on viable calculations for worldwide cost of production. A critical first step necessary to ban dumping is the conclusion of a worldwide agreement on a method for calculating the cost of production of sugar and other commodities in fair and equitable manner for all countries. In June 2004, the United Nations Conference on Trade and Development created a commodities task force which could provide an immediate forum for such negotiations. Alternatively, the WTO should also take up the challenge and develop new rules for calculating the cost of production and ban all dumping based on such rules.

I. Dominican Republic-Central American Free Trade Agreement: An overview

El Salvador, Guatemala, Honduras and Nicaragua signed the original Central America Free Trade Agreement (CAFTA) with the United States in December 2003. Since then, both Costa Rica and the Dominican Republic have also signed the agreement, which is now referred to as the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA). Although all seven governments (including the United States) have now officially signed the final text,[1] as of April 2005 only the national legislatures of El Salvador, Honduras and Guatemala had formally ratified the pact.[2]

In each of the countries that ratified the agreement, the government faced significant opposition from domestic civil society. These governments resorted to controversial, undemocratic parliamentary maneuvers to secure a favorable vote on the DR-CAFTA.[3] They also resorted to varying degrees of repression against opponents, which included the killing of two protestors in Guatemala.[4] Nevertheless, civil society groups throughout Central America have continued to mobilize strong grassroots opposition to the agreement based on concerns over the potential negative impacts on everything from agriculture to access to affordable medicine.[5]

In the United States, 2004 election year politics—combined with dogged domestic opposition from labor, environmental, church, development, textile, sugar and other agricultural constituencies—generated enough opposition to prevent the Republican leadership in the House of Representatives from bringing the DR-CAFTA to a vote last year. Both the House and the Senate must approve trade pacts. The Senate is more likely than the House of Representatives to approve DR-CAFTA, but even in the Senate, significant opposition has materialized.[6] The vote in the House is expected to be close—possibly as close as the one-vote margin with which the House passed "fast track" negotiating authority for the president in the summer of 2002. Congressional hearings have been scheduled in April, but House Republican leaders will not likely bring this trade pact to a vote unless they believe they have a good chance of passing the legislation.

Following its success in the 2004 election, the Bush Administration is in a stronger political position to win passage of DR-CAFTA in 2005. With its trade policy stalled over agriculture at the World Trade Organization (WTO) and Free Trade Area of the Americas (FTAA) negotiations, as well as with other FTAs (e.g., Thailand, Panama and Andean pacts) still pending, the Bush Administration wants to secure passage of DR-CAFTA in 2005 to regain momentum. What happens to DR-CAFTA in 2005 will be an important litmus test for how the Bush Administration's wider trade agenda is likely to fare during this second term.

The debate over DR-CAFTA comes at a unique historical moment. The U.S. budget crisis is forcing President Bush and lawmakers to make cuts in U.S. agriculture programs.[7] In the past year, Brazil has led successful challenges at the WTO against both U.S. cotton subsidies and EU sugar subsidies. Although these WTO decisions did not address the root causes of the current practice of dumping agricultural commodities on world markets at below the cost of production, they did substantially increase the political pressure to reduce government agricultural subsidies in developed countries. Given this historic moment in U.S. trade and agricultural policy, it is instructive to review the current U.S. sugar program for guidance on how to more effectively address the devastating practice of dumping agricultural commodities on world

markets, and how to move toward a more viable vision for agricultural economies and rural communities both in the U.S. and abroad.

The sugar program is the only major U.S. commodity program that does not require direct government payments to work effectively and does not dump surpluses onto the world market at below cost. Instead, the program relies on managing supply by allocating quotas on both imports and domestic production to avoid expensive and unwanted surpluses that would otherwise increase the economic pressure to dump. The time is ripe to identify, support and build upon agricultural and trade policies that—like the U.S. sugar program—provide farmers around the world with a fair price in the marketplace without the need for massive direct government subsidy payments prevalent in developed countries.

Yet DR-CAFTA—combined with existing NAFTA commitments to import additional sugar from Mexico—would likely collapse the sugar program by opening the United States' domestic market to increased sugar imports. This would ultimately result in the suspension of key domestic inventory management mechanisms under the current farm bill. Such a collapse of the sugar program would have severe ramifications not only for the U.S. sugar industry, but also for the 41 other countries that currently receive more than double the world market price for the sugar they export to the U.S. The world market price for sugar is often referred to as the world "dump" market price (about 11 cents per pound) because sugar is sold internationally at about half the world average cost of production (about 22 cents per pound). The United States' supported domestic price of sugar is about 23 cents per pound.

In April 2004, the Institute for Agriculture and Trade Policy (IATP) completed an analysis of the final negotiated text of the original Central America Free Trade Agreement. That report assessed the likely impacts of the agreement on market access, intellectual property, sanitary and phytosanitary measures on most agricultural sectors.[8] While it examined the overall impacts of CAFTA on agricultural sectors, the report focuses more narrowly on the potential ramifications of the DR-CAFTA on the sugar economy in the United States as well as identifying ramifications of the pact for Central American and other sugar producing countries around the world.

II. The DR-CAFTA proposal

DR-CAFTA proposes a 15-year schedule that gradually increases the amount of Central American sugar allowed into the United States under each of the participating countries' allocation for their nominal tariff-rate quota. The nominal TRQ is part of a two-tiered importing system that allows 41 countries to export into the United States specified quantities (quotas) of sugar at a lower, "nominal" tariff rate than usually applies, thereby ensuring a certain minimum level of access—currently about 13 percent of U.S. consumption—to the U.S. domestic market.[9] (See Appendix A for a more detailed explanation of the sugar TRQ system.)

Under the WTO Agreement on Agriculture, the U.S. allows the five original CAFTA countries to export into the United States 126,365 metric tons of sugar duty free.[10] In August 2004, negotiators signed an agreement that officially included the Dominican Republic in CAFTA. At 185,335 metric tons, the Dominican Republic holds the largest current sugar TRQ for the U.S. of all DR-CAFTA countries. DR-CAFTA countries therefore are allotted a combined TRQ of 311,700 metric tons to export annually to the U.S. This amount represents 28 percent of the 1.12 million metric tons in total U.S. sugar imports allocated to 41 countries under the current WTO Agreement on Agriculture.[11] Clearly, the DR-CAFTA members already have a strong presence in the U.S. market.

Under DR-CAFTA, the United States would establish additional TRQs for the five original Central American countries starting at 99,000 metric tons (mt)[12] in the first year, gradually growing to over 140,000 additional metric tons over 15 years. The Dominican Republic's TRQ would increase 10,000 mt in the first year. Thereafter, the Dominican TRQ would increase 2 percent annually, i.e., by 200 mt per year. DR-CAFTA countries' combined TRQs would add 153,140 mt annually to U.S. sugar imports by year 15 of the agreement, with an additional 2,640 mt added annually after that in perpetuity. The following table shows the metric tonnage allotments for DR-CAFTA countries to the U.S. market for 2003-04 along with the quotas proposed by DR-CAFTA.

Table 1. 15-year phase-in of DR-CAFTA tariff rate quotas in metric tons[13]

CAFTA sugar import access	2003-04 quota	Increase year 1	Increase year 2	Increase year 15[a]	Total, year 15	Annual increase year 16 +
Guatemala	50,546	32,000	32,640	49,820	100,366	+940
El Salvador	27,379	24,000	24,480	36,040	63,419	+680
Nicaragua	22,114	22,000	22,440	28,160	50,274	+440
Honduras	10,530	8,000	8,160	10,240	20,770	+160
Costa Rica	15,796	11,000 2,000[b]	13,220	16,080	31,876	+220
Dominican Republic	185,335	10,000	10,200	12,800	198,135	+200
Total	**311,700**	**109,000**	**111,140**	**153,140**	**464,840**	**+2,640**

NOTES

a. DR-CAFTA TRQ increases vary from country to country from years 2-15.

b. Additional organic 2000 mt TRQ allocated to Costa Rica.

III. Would DR-CAFTA threaten the viability of the U.S. sugar program?

There are two crucial questions raised by the DR-CAFTA proposal. One is whether the increased sugar imports allowed under DR-CAFTA would increase the total volume of U.S. sugar imports over a 1.39 million metric ton "trigger level" that has been established by Congress in the 2002 Farm Bill. Exceeding this trigger level would suspend the U.S. Department of Agriculture (USDA)'s authority to limit domestic production through the assignment of marketing allocations for domestic processors. A second is whether the increased metric tonnage allotments for imported sugar granted to the participating countries under the agreement would drive down the domestic U.S. sugar price below the non-recourse loan rate established by Congress and undermine the mandate of the sugar program to operate at no cost to taxpayers to the maximum extent possible. (See Appendix A for more detailed explanation of how the U.S. sugar program balances supply and demand through a three-tiered approach that includes: 1. the non-recourse loan program; 2. marketing allotments [domestic quotas]; 3. and import restrictions through a tariff-rate quota system.)

In the 2002 Farm Bill, Congress established a 1.39 million metric ton "trigger level" for sugar imports used for domestic food consumption. If sugar imports exceed this amount, the Farm Bill automatically suspends the authority of the Secretary of Agriculture both to limit domestic production through marketing allocations (quotas) and to block excess reserves from being sold on the market.[14] Congress has also established a statutory loan rate for sugar in the 2002 Farm Bill that sets a floor under the market price for U.S. sugar processors through a non-recourse loan program administered by the Commodity Credit Corporation (CCC) within the USDA. This non-recourse loan helps to ensure that processors can at least meet their cost of production and that buyers pay a fair price for sugar in the U.S. domestic market. Unlike other commodity programs, sugar loans are made to processors, not directly to farmers. This is because both sugar beets and sugarcane are perishable and must be processed and stored before they can be traded. However, a condition of the loan is that processors must provide payments to farmers in proportion to the value of the loan. Congress mandates the USDA to operate this program at no cost to taxpayers to the maximum extent possible[15] (see Appendix A).

The U.S. Trade Representative's office estimates that during DR-CAFTA's first year, increased sugar market access for Central American countries would only amount to about 1.2 percent of U.S. sugar consumption, and grow to about 1.7 percent by year 15.[16] The USTR likens this amount to "a spoonful [of sugar] a week."[17] Nevertheless, DR-CAFTA would threaten the delicate balance achieved by the sugar program's management of sugar supplies through limits on imports and domestic production. Upsetting this balance could disrupt existing mechanisms—the TRQ system, the non-recourse loan program and the marketing allocations—used to match sugar supplies to domestic demand. Such a disruption could undermine the domestic price of sugar as well as the current congressional mandate to operate the sugar program at no cost to the government to the maximum extent possible.

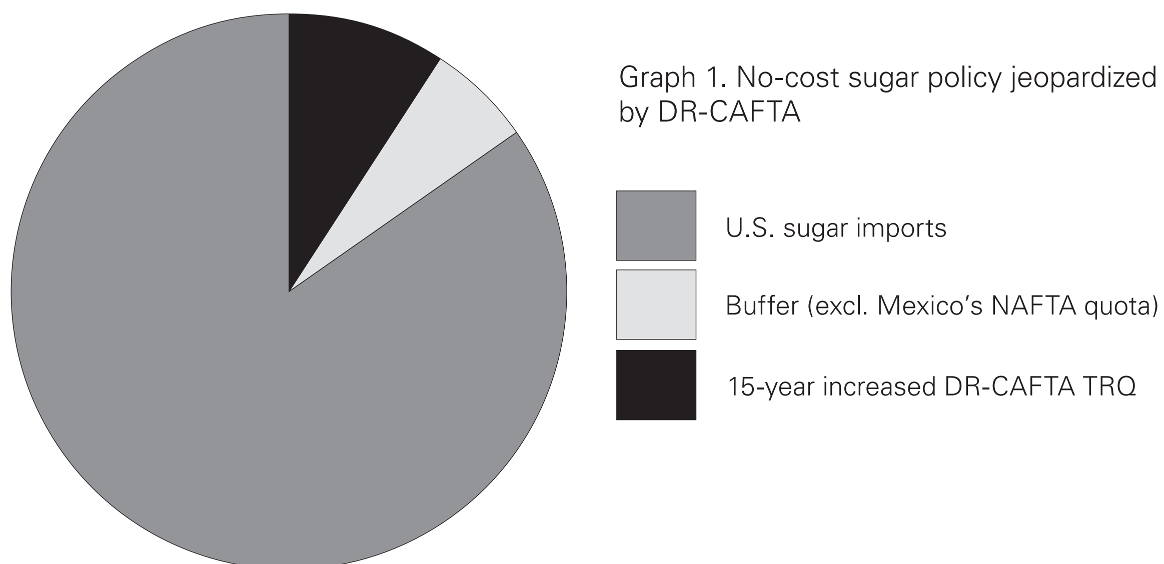
On the surface, the total amount of increased sugar imports proposed under DR-CAFTA over the 15-year implementation period—153,140 metric tons—would not alone be enough to reach the 1.39 million ton trigger level that would suspend the authority of the Secretary of Agriculture to manage domestic supplies. The total 2003-04 tariff rate quota allocations for raw cane sugar into the U.S. will be 1,117 million mt.[18]

An additional TRQ of 22,000 mt[19] is allocated for refined sugar imports, bringing the WTO minimum TRQ up to 1,139 million mt. The remaining TRQ buffer—before CAFTA tonnage is counted—under the trigger level comes to 251,000 mt. Subtracting the 153,000 mt that would be added by DR-CAFTA over 15 years would leave a remaining buffer under the trigger of only 98,000 mt.

Table 2. Would DR-CAFTA suspend supply and inventory management?

Trigger level from Farm Bill		1.39
2003-04 total non-NAFTA imports	(1.139)	
CAFTA 15-year TRQ increase	(0.153)	
Less combined CAFTA and non-NAFTA imports		(1.292)
Remaining buffer before marketing allotments suspended		(0.098)

NOTE: All figures above are in millions of metric tons.



Graph 1. No-cost sugar policy jeopardized by DR-CAFTA

Although DR-CAFTA itself appears on the surface to allow only moderate and gradual increases of sugar imports, the Bush Administration's assurance that DR-CAFTA would not harm the sugar industry is disingenuous. There are at least three important factors that the USTR does not account for that could lead to the destruction of the U.S. sugar program:

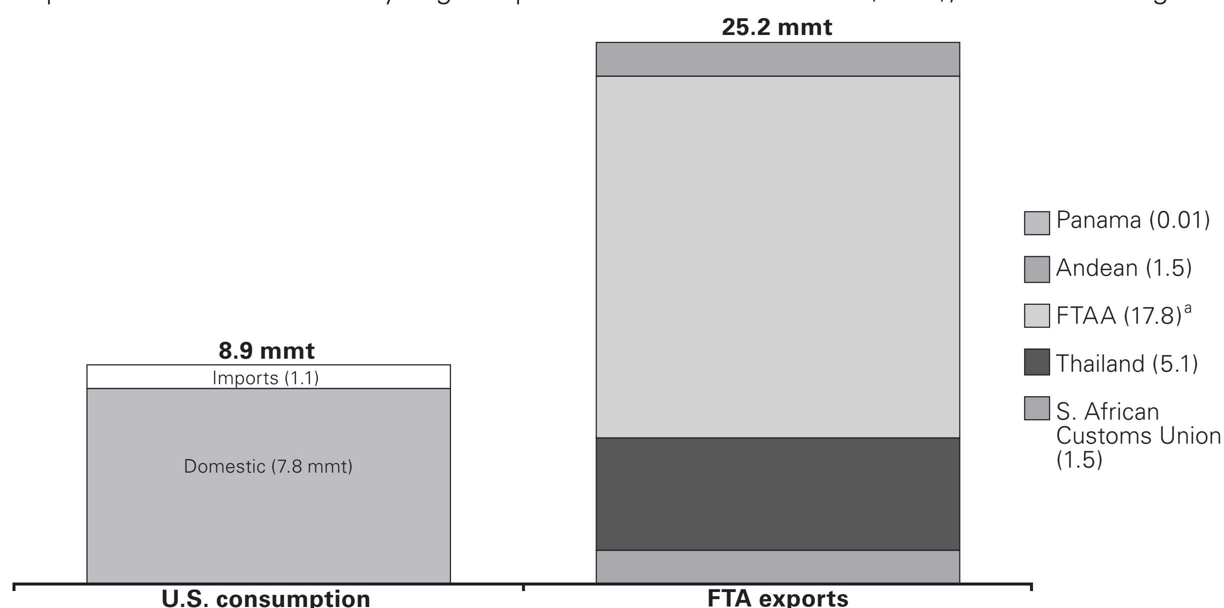
1. Mexican sugar imports allowed under unused NAFTA quotas are likely to increase in coming years.

2. The Bush Administration refuses to take sugar off the negotiating table in several pending trade agreements—such as Thai, Panamanian, Andean and South African FTAs, as well as all of South America under the Free Trade Area of the Americas—that have an even greater potential to increase sugar imports than DR-CAFTA.

3. The administration refuses to acknowledge the potential cumulative impacts of the agreement on the continued viability of the sugar program when combined with existing stock reserves of 565,000 mt[20] that could be released onto the domestic market should imports exceed the trigger level for suspending marketing allocations.[21]

Assuming all participating countries fully utilize their new quota of 153,000 mt under DR-CAFTA, then any expansion of sugar TRQs of more than 98,000 mt resulting from any pending trade negotiations, or resulting from Mexico utilizing its unused quota under NAFTA, would trigger the suspension of USDA authority to implement marketing allotments and to block sugar reserves from being released onto the market. If imports exceed the trigger level and marketing allocations were suspended, then increased domestic production would combine with the release of currently blocked sugar reserves to flood the market and collapse the domestic price of sugar.

Graph 2. Potential FTA country sugar exports in million metric tons (mmt), 2002-04 average



NOTES

a. Excludes CAFTA and Andean. Argentina, Australia, Bahamas, Belize, Bolivia, Brazil, Canada, Costa Rica, Dominican Republic, Ecaudor, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, South Africa, St. Kitts and Nevis, Swaziland, Thailand, Trinidad and Tobago and Uruguay.

SOURCE: USDA/FAS November 2004; USDA, April 2005 WASDE.

The secretary of agriculture has some flexibility to respond to increased imports by further restricting domestic sugar production through a reduction in marketing allotments. However, as stated previously, the secretary's authority to impose marketing allotments is automatically suspended by law when sugar imports exceed the trigger level of 1.39 million metric tons. This means that once imports exceed this level, U.S. sugar processors will be free to produce as much sugar as they want. This in turn would mean individual farmers would also be free to plant more sugar beets and cane because they would no longer be restricted by the quota limits they share with processors. We know from experience in other commodities that, because no individual farmer can affect market price with his or her production decisions alone, the response to a removal of production limits would likely be an initial increase in sugar production causing prices to fall. As prices fall, some sugar acreage would likely be shifted to other crops, potentially depressing prices for those

commodities. Once the price of sugar fell and sugar refineries closed, they would not likely reopen—especially since imports will have been increased.

Additionally, the secretary would lose the authority to block the release of the nearly 565,000 tons of sugar that processors now hold in reserve at their own expense. To avoid this additional cost—especially during a period of falling prices—experience suggests processors would release their reserves onto the market, further driving down prices. The further the price fell, the more sugar would be forfeited by processors to the Commodity Credit Corporation (CCC), and the higher the storage costs to the federal government would climb. The government would be hard-pressed to continue to accept growing surplus sugar forfeited to the CCC under the non-recourse loan program because the increased storage costs would break the congressional mandate for the sugar program to operate at no cost to taxpayers to the maximum extent possible.[22]

Such accelerated costs would make the sugar program increasingly difficult to defend politically and could ultimately cause the complete dismantling of the program. Whether the sugar industry could convince Congress and the president to allocate direct government payments to sugar producers similar to those found in other commodity programs remains an open question. However, the increasing budget deficit makes the pursuit of that option a truly daunting proposition. Given the current level of domestic and international acrimony over U.S. agricultural subsidies, it appears just as likely that U.S. sugar policy would move steadily towards deregulated production, lower domestic prices and the ultimate demise of up to 80 percent of the U.S. sugar industry.[23] In addition to concerns over domestic economic impacts, the undermining of the sugar program raises the question of how the lower U.S. domestic price would affect revenues to and market shares of the 41 countries currently exporting sugar to the U.S. market.

U.S.-Mexican dispute over high fructose corn syrup and sugar

Mexico has not used its additional NAFTA sugar quota for two reasons. One reason is chaos in the Mexican sugar industry that culminated in the government expropriating 27 bankrupt sugar mills in 2001.[24] Another reason is a complicated ongoing trade dispute between the United States and Mexico involving sugar and high fructose corn syrup. The dispute involves the validity of a side letter on sugar exchanged by the U.S. and Mexican governments to help secure passage of NAFTA by the U.S. Congress. The controversial side letter altered the original NAFTA text to reduce the amount of Mexican sugar allowed into the United States during the transition period set out in NAFTA by, first, limiting Mexican sugar access to the U.S. to 250,000 mt of surplus production during transition years 2001-07. And, second, amending the original formula for calculating the Mexican sugar surplus to exclude sugar displaced by high fructose corn syrup (HFCS) consumption. The old formula of Mexican sugar production less Mexican domestic sugar consumption was replaced with Mexican sugar production less the sum of Mexican domestic sugar and HFCS consumption. While the side letter was included in the version of NAFTA that passed the U.S. Congress, it reportedly was not included in the version that passed Mexico's Congress. Mexico subsequently rejected the side letter's validity, but the U.S. maintains it is valid.[25]

The situation as it stands now is that negotiations continue between the U.S. and Mexico to try resolve the outstanding issues related to this sugar/high fructose corn syrup dispute. Depending on the outcome of the dispute, Mexico could end up exporting up to 250,000 metric tons of additional sugar under its existing

NAFTA quota. Furthermore, Mexico can ship unlimited quantities of sugar to the United States while paying an over-quota tariff that, under NAFTA's terms, is decreasing over the 15-year transition period from 16 cents per pound (raw value) to zero.[26] In 2005, the tariff stands at 4.53 cents per pound and will reach zero in 2008. Regardless of the outcome of the dispute, Mexico will be granted unlimited access to the U.S. domestic sugar market starting in 2008 under sugar tariff phase-outs required by NAFTA.[27] If Mexico does eventually use over 98,000 mt of its NAFTA quota, then such an increase in Mexican imports, combined with the additional imports allowed in DR-CAFTA, would in fact put imports over the Farm Bill's trigger level even without the approval of any of the other pending FTAs. Because of the uncertainty in the Mexican sugar industry, it is unclear how much additional sugar Mexico will be able to export to the U.S. However, at least one study estimates that Mexican sugar exports will reach 700,000 mt by 2013.[28]

Sugar compensation mechanism under DR-CAFTA

DR-CAFTA does contain a sugar compensation mechanism that would allow the U.S. government to buy out Central American importers rather than allow them to use their increased quotas under the agreement.[29] This provision has drawn criticism because the cost of using the mechanism would be difficult to defend given budget pressure from the growing deficit. Some have also criticized the vagueness of the provision, which they worry could allow the use of sugar, sugar-containing products or even other commodities (e.g., nonfat dry milk) in a manner that violates the United States' WTO commitments to refrain from dumping commodities at below the cost of production on world markets.[30]

Estimates for the cost of this program run as high as $28 million in the first year of the agreement alone, which drew criticism from the entire sweetener industry.[31] In a March 22, 2004 report, the U.S. Trade Representative's Agricultural Technical Advisory Committee for Trade in Sweetener and Sweetener Products stated: "[W]e do not understand how policy makers could justify spending $28 million per year in support of the sugar program, with checks being written to overseas interests, at the same time that other commodity programs may be squeezed at home."[32]

This compensation mechanism might be used to curtail increased imports under DR-CAFTA from reaching the trigger level for suspending USDA's marketing allocation authority under the 2002 Farm Bill, but there are no guarantees because its use is discretionary on the part of the U.S. government.[33] However, if surplus sugar or surplus sugar-containing products were used as compensation, this could turn the U.S. sugar program from a non-dumping program into a dumping program. It could result in the U.S. passing its surplus sugar or even other commodities through Central American countries to dump on the world market at below the cost of production—potentially in violation of WTO rules.[34] Or, if cash were to be used, it would change the program from a no-cost program into a taxpayer-subsidized program requiring budget outlays. Regardless, if Mexico were to exercise its right to import its full quota under NAFTA, or if additional imported sugar is allowed in any other pending FTAs, this sugar compensation mechanism may ultimately be unable to prevent import levels from reaching the trigger level.

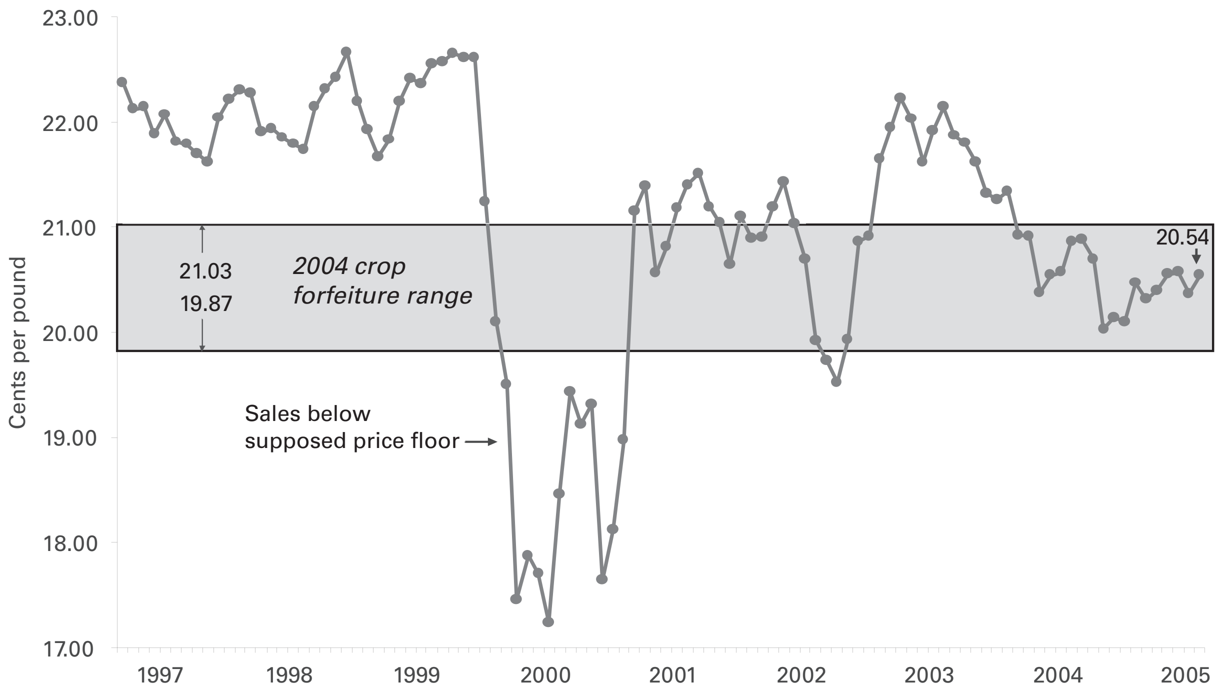
IV. Economic impacts of DR-CAFTA on the U.S. sugar industry

A 2003 North Dakota State University (NDSU) study projects that if sugar imports were to rise over the current TRQ level—either under DR-CAFTA or under other trade agreements, or a combination of these—domestic sugar prices would fall significantly. As sugar imports rose beyond 500,000 mt over current levels, domestic sugar prices would fall to a point where the sugar production in certain regions of the U.S. would no longer be economically viable.[35] Sugar beet production would be hit first because beets have higher production costs than sugarcane. However, acreage for both beet and cane sugar would begin to be taken out of sugar production.[36] This projected reduction in sugar crop acreage raises the question of which crops would be planted on these acres and what would be the price impacts on other commodities that would be substituted for sugar.

The further sugar imports grow beyond 500,000 tons, the faster domestic sugar production is shut down. The NDSU study projects "that domestic supply would decrease 25% for sugar beets and 15% for sugar cane for every 10% decrease in price." Cane sugar refineries would not be affected to the same degree as beet refineries because they would have access to cheaper imported sugarcane to meet their demand. As sugar beet prices fell, increasing numbers of local farmers would discontinue planting beets. Unlike cane refineries, sugar beet refineries would become even less competitive because cheaper sugar beet imports would not be available to offset the supplies lost from local farmers who would discontinue beet production. If sugar imports were to exceed 2 million tons, the NDSU study concludes U.S. sugar beet production would cease altogether and remaining cane producers would be left with less than 20 percent of the total U.S. domestic market.[37]

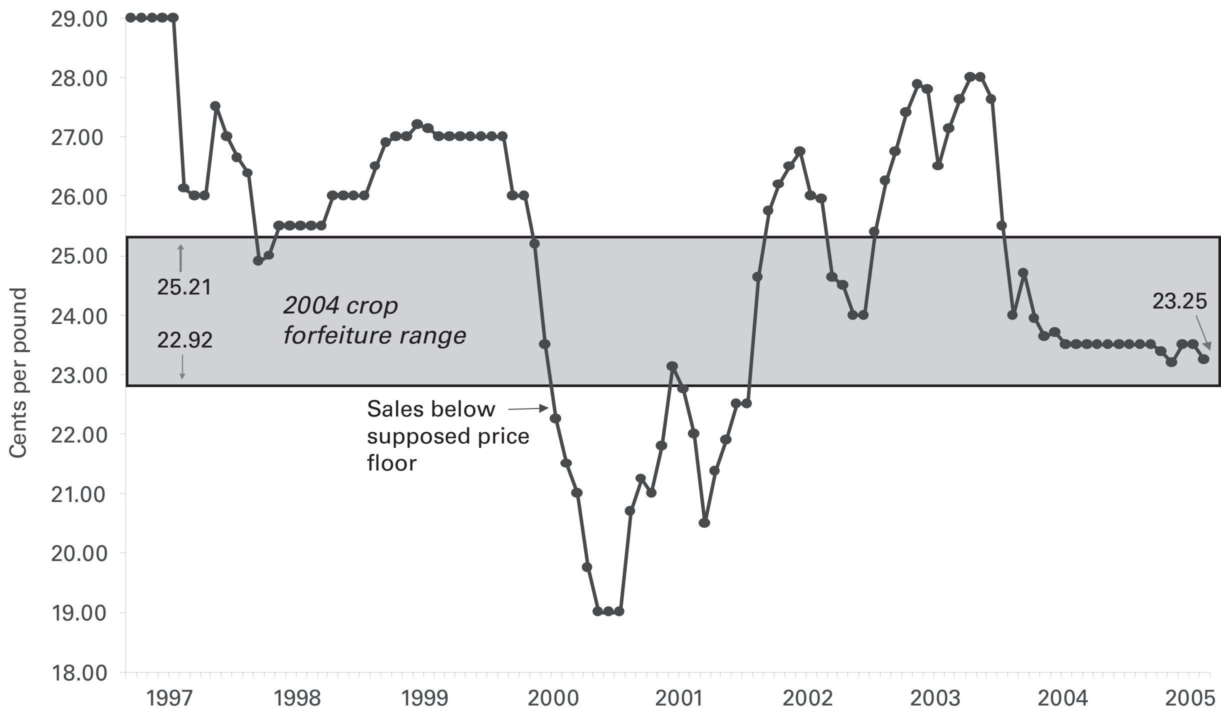
In the 1996 Farm Bill, Congress removed marketing allocation authority for the sugar program that had prevented costly overproduction.[38] Marketing allotments are the domestic quotas given to sugar processors which are based on the projected domestic sugar consumption for the upcoming year, less carryover reserves and imports.[39] (See also Appendix A.) The suspension of marketing allotments was a major contributor to the collapse of sugar prices between 1997 and 2001, which caused the closure of 28 U.S. sugar mills and refineries. Although Congress restored marketing allotments for sugar in the 2002 Farm Bill, increased sugar imports under DR-CAFTA and other proposed trade agreements threaten to repeat the price collapse experienced between 1996 and 2002, and threaten the estimated remaining 146,000 jobs and $9.5 billion that the surviving sugar industry contributes to the U.S. economy.[40]

Graph 3. U.S. raw cane sugar prices, 1996-2005



SOURCE: USDA. Raw cane sugar, nearby #14 contract, delivered New York. Monthly average prices October 1996–March 2005.

Graph 4. U.S. wholesale refined beet sugar prices, 1996-2005



SOURCE: USDA. Wholesale refined beet sugar, Midwest markets. Monthly average prices, October 1996–March 2005.

Table 3. 30 sugar mill and refinery closures since 1996

Beet closures	**Cane closures**	Cane refinery closures
Spreckels Sugar *Manteca, Calif. (1996)*	Ka'u Agribusiness, *Hawaii (1996)*	C & H, *Aiea, Hawaii (1996)*
Holly Sugar *Hamilton City, Calif. (1996)*	Waialua Sugar, *Hawaii (1996)*	Imperial, *Everglades, Fla. (1999)*
Western Sugar *Mitchell, Neb. (1996)*	McBryde Sugar, *Hawaii (1996)*	Imperial, *Sugarland, Tex. (2003)*
Great Lakes Sugar *Fremont, Ohio (1996)*	Breaux Bridge Sugar, *La. (1998)*	Domino, *Brooklyn, N.Y. (2004)*
Holly Sugar, *Hereford, Tex. (1998)*	Pioneer Mill Company, *Hawaii (1999)*	
Holly Sugar, *Tracy, Calif. (2000)*	Talisman Sugar Company, *Fla. (1999)*	
Holly Sugar, *Woodland, Calif. (2000)*	Amfac Sugar, Kekaha, *Hawaii (2000)*	
Western Sugar, *Bayard, Neb. (2002)*	Amfac Sugar, Lihue, *Hawaii (2000)*	
Pacific Northwest *Moses Lake, Wash. (2003)*	Hawaiian Commerical and Sugar *Paia, Hawaii (2000)*	
Amalgamated Sugar *Nyssa, Ore. (2005)*[a]	Evan Hall Sugar Cooperative, *La. (2001)*	
Michigan Sugar *Carrollton, Mich. (2005)*[a]	Caldwell Sugar Cooperative, *La. (2001)*	
	Glenwood Sugar Cooperative, *La. (2003)*	
	New Iberia Sugar Cooperative *La. (2005)*	
	Jeanerette Sugar Company, *La. (2005)*	
	U.S. Sugar, *Bryant, Fla. (2005)*[b]	

NOTE: In 2005, 24 beet factories, 21 raw cane mills and seven cane refineries remain in operation.

a. Suspended operations for 2005.

b. Phasing out operations, 2005-07.

Apart from the loss of income for farmers growing sugar and the loss of jobs in the sugar processing industry, there are other crucial questions raised about the potential loss of over 80 percent of existing U.S. sugar production:

1. What would happen to the crop acreage removed from sugar production?
2. What other crops would be planted on abandoned sugar acreage?
3. How much would such a shift in crop acreage to other agricultural commodities cost U.S. taxpayers in additional farm program payments?
4. Would Congress replace the existing sugar program with a program similar to other program crops that cost taxpayers billions of dollars annually in direct government subsidies? If so, how much would such a new sugar program cost taxpayers?
5. Would the additional production of other commodities from former sugar acreage lower domestic and world market prices and increase international dumping levels for those commodities?
6. How much would the sugar compensation mechanism cost U.S. taxpayers?
7. Would the sugar compensation mechanism be WTO-compliant if it used surpluses instead of direct payments to compensate exporters from foregoing their TRQs under DR-CAFTA?
8. What would be the impacts to the revenues currently received by the 41 countries that now export sugar to the United States?

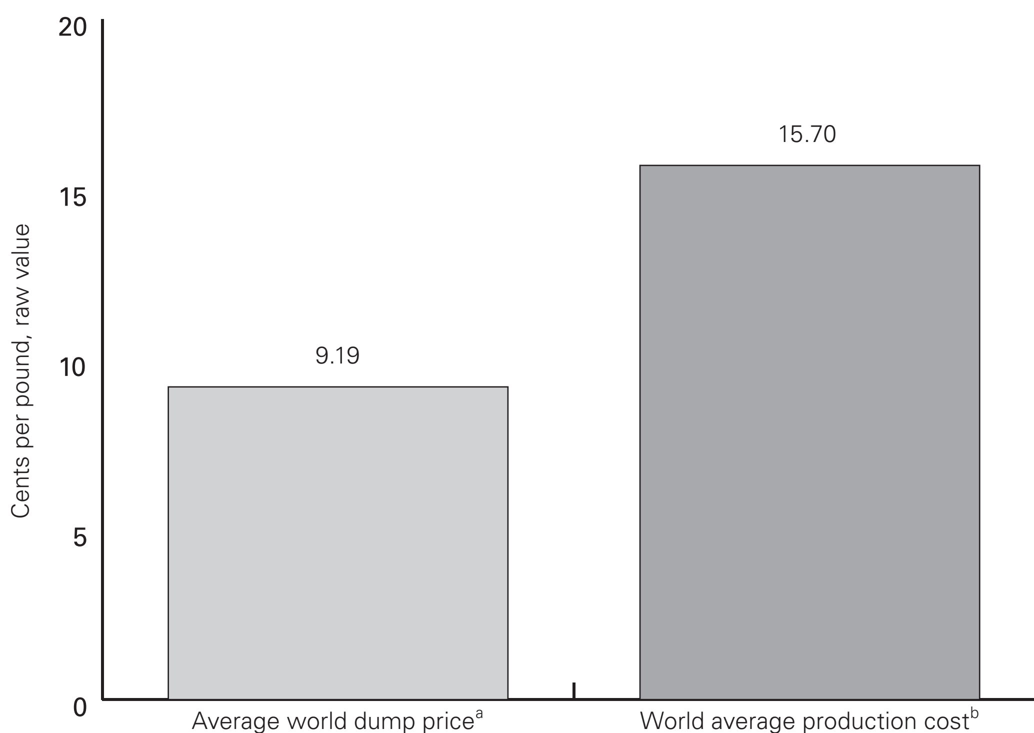
These questions are beyond the scope of this paper, but Congress should take the responsibility of answering them before voting on DR-CAFTA.

V. DR-CAFTA: Implications for developing countries

The U.S. sugar program's TRQ system currently allocates 1.139 million mt, or about 13 percent of U.S. domestic sugar food consumption, to 41 countries and up 250,000 tons of Mexican surplus production under NAFTA. All these countries receive the U.S.-supported price of about 20 cents per pound (raw value) for the sugar they export to the U.S., which is more than double the world market price of about 9 cents per pound (raw value). If DR-CAFTA and other pending trade agreements result in the dismantling of the U.S. price support system for sugar, then the North Dakota State University study estimates importers will gain more than 80 percent of the domestic market when the resulting lower prices completely wipe out beet production and a majority of cane production in the U.S.[41]

On the surface, this projected collapse of the U.S. sugar industry might seem like good news to sugar-exporting countries. However, the spoils would not be divided equitably among the 41 countries exporting sugar to the U.S. Only Brazil's domestic wholesale price of 8 cents per pound is lower than the world market price. But even Brazil, the world's lowest-cost sugar-exporting country, maintains an 18 percent import tariff and other indirect subsidies to protect itself against the low world dump market price.[42]

Graph 5. World sugar dump market price:
Barely more than half the world average cost of producing sugar



NOTES

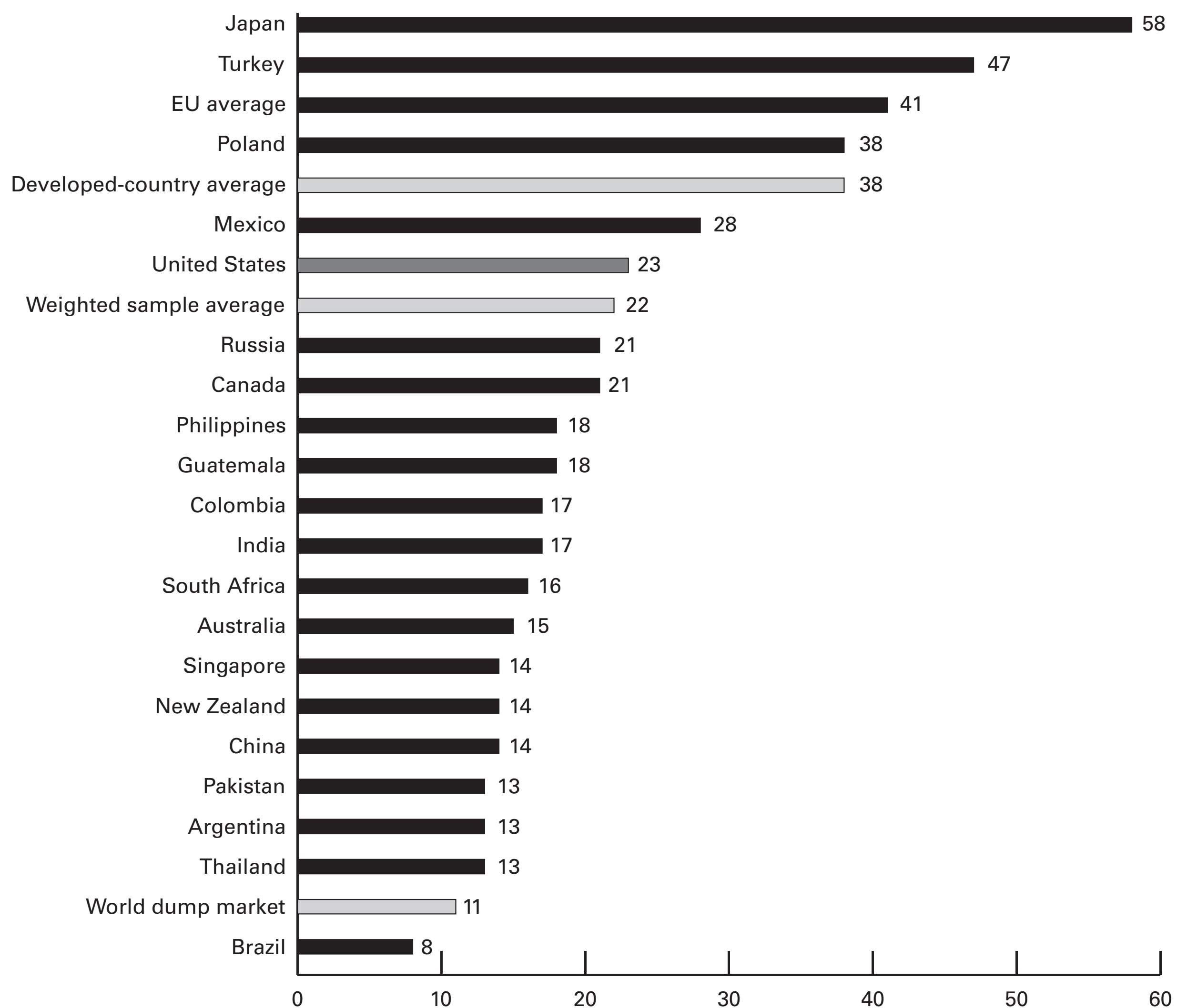
a. New York contract #11, f.o.b Carribbean imports. Source: USDA.

b. Beet and cane sugar weighted average, raw value. Source: "The LMC Worldwide Survey of Sugar and HFCS Production Costs: The 2003 Report," LMC International, Ltd., Oxford, England, December 2003.

Although a few of the world's lowest cost sugar exporters (i.e., Australia, Brazil, South Africa, and Thailand) may or may not make up in volume what they lose in price by gaining a greater share of the U.S. domestic market, clearly other countries would lose much of the value of their existing quota as U.S. domestic sugar prices fall to the world dump market price.

For example, Haiti, one of the poorest countries in the world, currently holds a TRQ of 7,258 mt. At the current U.S. support price of 20 cents per pound (raw value), the value of Haiti's TRQ is $3,200,230. However, if the U.S. price were to fall to the current world dump market price of 9 cents per pound under the dismantlement of the U.S. sugar program, then the value of Haiti's TRQ would fall to $1,440,104—a net loss of $1,760,126—more than half its current TRQ value under the U.S. sugar program.

Graph 6. Actual wholesale refined sugar prices average double the world market dump price; U.S. at world average level; other developed countries 65 percent higher (cents/pound, 2004)



SOURCES: World refined price, London futures contract #5, USDA; all others, LMC International, April 2005. Countries surveyed represent 82 percent of global production.

Finally, if current TRQ allocations were eliminated altogether, there is no guarantee that poorer developing countries would retain *any* access to the U.S. domestic market, because they would be forced to compete with lower-cost exporters who would likely end up with a disproportionate share of the market. After all, the 2000-04 average world market price for wholesale refined sugar was 22 cents per pound.[43]

The NDSU study does project that, if U.S. sugar imports were to rise to 2 million tons, world sugar prices would rise to 14 cents per pound as the U.S. domestic production decreases.[44] However, based on an economic analysis of other crops such as cotton and rice, the University of Tennessee's Agricultural Policy Analysis Center study indicates that such a rise in world prices would likely be temporary because exporting countries would increase production over time in response to the higher price. Such increased production by other major sugar exporting countries would eventually drive the price down, thereby nullifying the temporary benefits of a slightly higher world sugar price.[45]

For decades, the U.S. sugar program has offered a sound policy model that has successfully created market stability at little public expense while avoiding the structural overproduction that leads to dumping in international markets for other commodities that is particularly devastating to developing countries. Before we abandon this relatively successful policy, we should ask ourselves whether sugar producers around the world would be better off if we replaced the sugar program with some mutation of the failed policies of the other U.S. commodities that are becoming less defensible by the day.

VI. DR-CAFTA and the U.S. sugar program: Lessons for solving the dumping crisis

Many critics of U.S. and EU agricultural trade policies blame subsidy programs for low international commodity prices. They argue that developed countries should eliminate their agricultural subsidies to stop stimulating unwanted supply. Many developed countries overproduce a number of commodities, creating surpluses that, one way or another, usually end up dumped on the world market at below the cost of production, depressing prices for farmers and peasants worldwide. These critics contend that if subsidies stopped, so would unwanted surplus which, in turn, would help lift developing country farmers out of poverty by both raising world prices and increasing developing countries' export market shares.

However, researchers at the University of Tennessee's Agricultural Policy Analysis Center and others have found that subsidies are a symptom of low commodity prices rather than a root cause. More important factors are overproduction caused by a systematic dismantling of supply management and inventory mechanisms driven by the passage of NAFTA and the 1996 and 2002 Farm Bills. This overproduction is the root cause of U.S. dumping of agricultural commodities onto world markets at prices below the cost of production.[46] To understand the causes of dumping, it is critical to distinguish between commodity programs that depend on direct government payments to farmers and commodity programs that use supply and inventory management mechanisms that allow farmers to obtain a fair price from the market with little or no direct government costs.

For over a decade, IATP has tracked the gap between U.S. production costs for five major export commodities and the price at which they are exported on world markets. The numbers show an alarming increase in the levels of dumping for major commodities from the United States since passage of NAFTA and the 1996 Farm Bill.[47] Evidence from Argentina, Canada and Australia suggests that elimination of subsidies alone is not enough to reduce output—in all of these countries, wheat production actually increased when subsidy programs ended.[48] Additionally, the University of Tennessee's Agricultural Policy Analysis Center found lower agricultural commodity prices do not result in land being removed from production causing an automatic rise in prices, as is commonly assumed under classic market theory. Instead, a lower price for one commodity simply causes farmers to shift crop acreage to a limited number of other feasible crops, thereby adding to the overproduction problem in other sectors.[49] This raises a crucial question in the debate over DR-CAFTA and sugar: *What happens to the U.S. sugar crop acreage taken out of production by falling sugar prices?*

Nor does the theory of comparative advantage offer much real hope to the world's poorest countries unlikely to fare any better against rising economic powerhouses like Brazil, India and China than they have against today's giants. An expanded share of the world market for developing countries—even if realized—does not necessarily guarantee better incomes to the world's poorest farmers. Evidence instead shows that eliminating developed-country subsidies would not increase world prices for major commodities to levels anywhere near the cost of production, and any price increase would likely be short-lived as other exporting countries increase production in response to any initial world price increases.[50] After all, it is rarely farmers who engage directly in trade. Rather, they sell to brokers and traders who then sell to the multinational conglomerates operating in world markets with enormous market power.

If dumping by multinational agribusiness cartels continues unabated, world agricultural commodity prices will continue to be forced downward. And such low prices will continue to threaten farmers everywhere whether or not developed-country subsidies are eliminated. However, implementing effective supply and inventory management systems—both domestically and internationally—holds the most promise for raising world agricultural commodity prices to the benefit of both subsistence peasant farmers in developing countries and small- and medium-sized family farmers in developed countries.[51] We should look to the U.S. sugar program and other supply management programs around the world for lessons on how to solve the unjust problem of dumping on world agricultural commodity markets.

VII. The U.S. sugar program: A viable alternative to other failing commodity programs

Based on this analysis, DR-CAFTA would jeopardize several positive aspects of the U.S. sugar program:

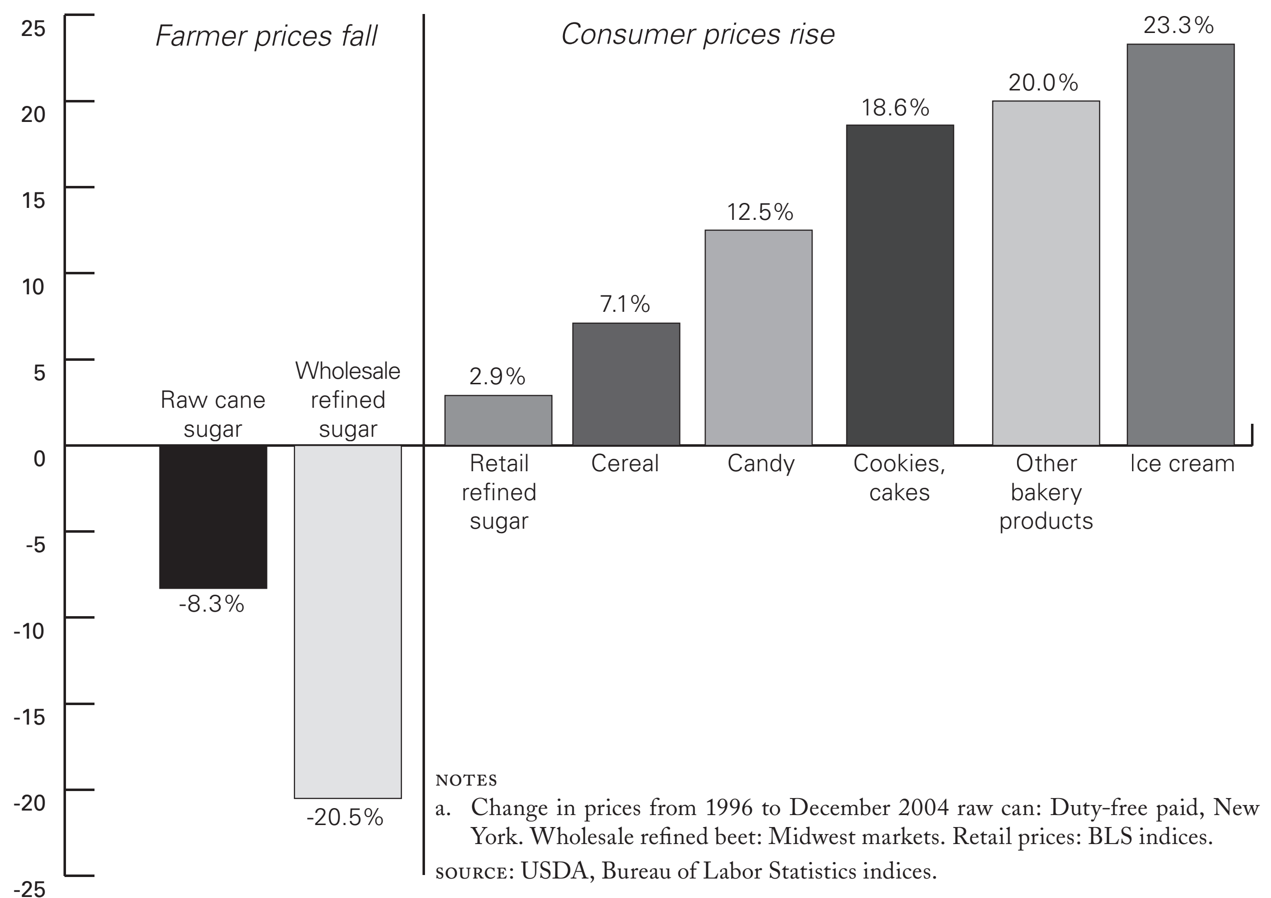
Fair prices for farmers

DR-CAFTA would jeopardize current congressional mandates ensuring U.S. farmers participating in the sugar program receive a fair price from the marketplace. It would reduce the supported domestic price now received by the 41 countries that export sugar to the U.S. The agreement also raises the likelihood of deregulation of the U.S. sugar market and would therefore threaten access to the lucrative U.S. sugar market for some of the world's poorest developing countries, some of which are disproportionately dependent on sugar export revenues.

No taxpayer subsidies

The U.S. sugar program is currently mandated by Congress to operate at no cost to taxpayers to the maximum extent possible. This is in stark contrast to failed policies epitomized by other budget-busting U.S. commodity programs that are becoming increasingly indefensible from fiscal, environmental and social perspectives.

Graph 7. From 1996 through 2004: Farmer prices for sugar fall, consumer prices for sugar and sweetened products rise[a]



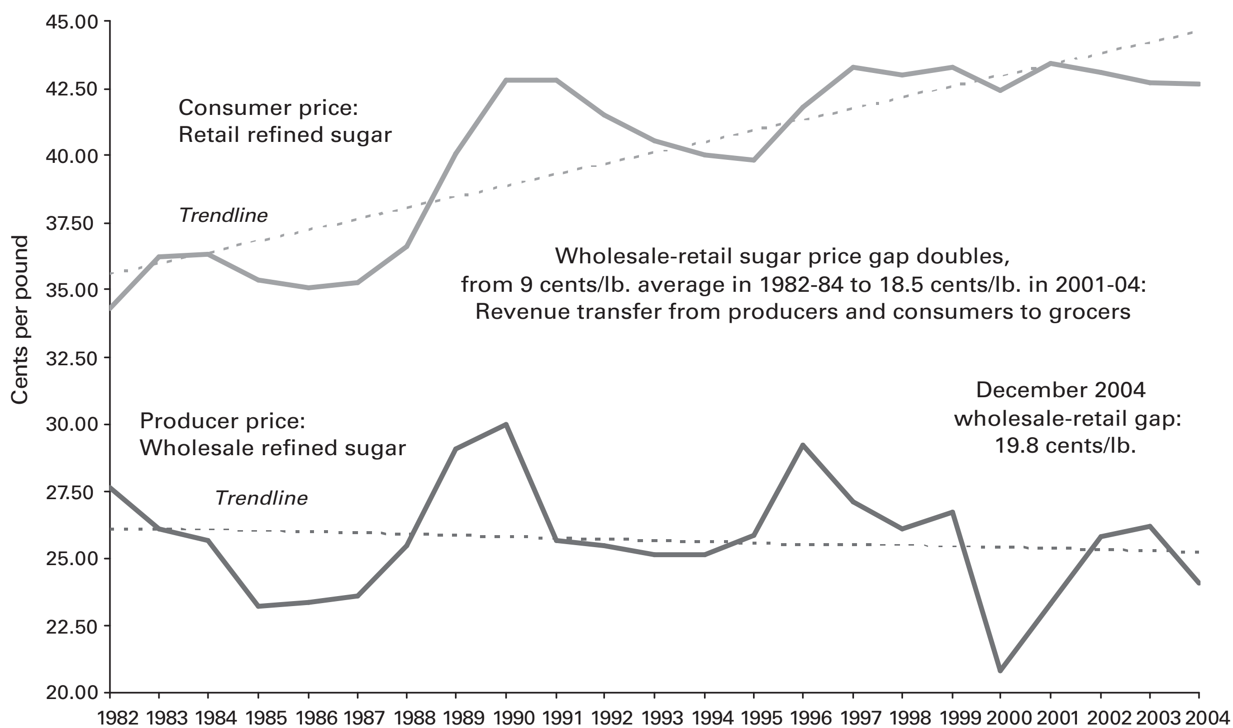
NOTES

a. Change in prices from 1996 to December 2004 raw can: Duty-free paid, New York. Wholesale refined beet: Midwest markets. Retail prices: BLS indices.

SOURCE: USDA, Bureau of Labor Statistics indices.

Critics of the sugar program claim that the sugar price support represents a hidden subsidy because consumers have to pay higher prices. But this assumes retailers will pass savings from lower prices to consumers. Given the concentrated market power of retailers, experience tells us this is not a credible argument. For example, while wholesale prices paid to sugar producers fell 20.5 percent between 1996 and 2004, the retail price for refined sugar rose 2.9 percent. Additionally, the prices for various sugar-containing products from cereals to ice cream climbed from 7.1 to 23.3 percent during the same period.

Graph 8. Wholesale-retail sugar price gap more than doubles:
No passthrough of lower producer prices to consumers (1982-2004)



SOURCES: USDA, BLS. Wholesale refined beet sugar, Midwest markets; U.S. retail refined sugar . Annual average prices 1982-2004. Linear trendlines.

Although classic economics would assume lower domestic sugar prices would spur greater demand and consumption, decades of steady growth in U.S. sugar demand fell off substantially from 1997-2000 despite a reduction in price. Nevertheless, consumer prices have not fallen in response to these lower prices. Market concentration at the retail level is the primary reason lower sugar prices are not being passed through to consumers, although demand has also been sapped by the rise of high fructose corn syrup as a replacement for sugar, by the low-carb diet craze, by increased imports and by slow economic growth. However, the bottom line is that the gap between wholesale and retail prices has doubled since 1982.

No dumping

Unlike other major U.S. commodity programs, the sugar program actually prevents dumping on the world market at below the cost of production. Dumping is especially devastating for developing-country farmers whose governments are being pressured at the WTO to dismantle border protections. Unlike rich countries, poor countries cannot afford to make direct subsidy payments to buffer their farmers from the devastatingly low world market prices for agricultural commodities caused by dumping. Additionally, the sugar compensation mechanism in the DR-CAFTA text poses the unacceptable threat of transforming the U.S. sugar program from a non-dumping to a dumping program. Dumping of sugar and all other commodities should be banned worldwide, and mechanisms created to enforce such bans.

Moving toward a more just agricultural and trade policy: Policy recommendations

1. Reject DR-CAFTA. This agreement would lead to the destruction of all the positive benefits of the U.S. sugar program including fair prices, no taxpayer expense and no export dumping on world markets. In addition, it would likely reduce income from most small developing countries that are currently exporting sugar into the United States.

2. Pursue multilateral negotiations. Neither sugar nor any other globally traded agricultural commodity should be negotiated in a piecemeal fashion in regional trade pacts like DR-CAFTA. Ideally, all agricultural commodities should be negotiated simultaneously, comprehensively and multilaterally. Such an approach would allow for adequate consideration to be given to the complicated and often subtle interrelationships among commodities, e.g., the relationship between sugar and high fructose corn syrup or the relationship between the cost of feed grains and livestock prices. At a minimum, no agricultural commodity should be negotiated in any trade agreement without the inclusion of all countries that are major exporters of a particular commodity—especially if any exporters are guilty of dumping (see Appendix B).

3. Make development a priority through preferential market access. Interested parties should review the current decision-making process for establishing TRQs for the U.S. sugar program. Such an effort could identify and develop new criteria for prioritizing TRQs to maximize development opportunities in poor countries based on the greatest need, e.g., the per capita income of the country or whether sugar is the sole commodity that is economically viable to export. Interested parties should consult with fair trade partners in both the U.S. and the global South to explore ways to improve labor, environmental and human rights in the sugar industry in all countries—including the United States. These consultations should explore the feasibility of developing additional criteria (e.g. environmentally sound farming practices or compliance with International Labor Organization standards) for obtaining U.S. sugar TRQs that could support legitimate reform efforts in sugar-producing countries.

4. Examine the U.S. sugar program as a domestic model. Interested parties should explore the possibility of putting a reformed U.S. sugar program forth as an alternative model for other commodities as pressure builds domestically to cut subsidies. As the debate heats up over the 2007 U.S. Farm Bill, consideration should be given to using the U.S. sugar program as a viable domestic model for cutting government payments, ending export dumping and providing more equitable market access to developing countries.

5. Examine the U.S. sugar program as an international model. Interested parties should explore the possibility of establishing an international commodity agreement for sugar that could be modeled on previous commodity agreements such as the International Coffee Agreement. Such an initiative could potentially raise the price of sugar in the world market to improve the livelihoods of sugar producers around the world. If successful, such an endeavor could provide a model for future agreements in other commodities.

6. Ban dumping of agricultural commodities onto world markets. All countries should take immediate steps to prevent agricultural exports from being dumped onto world agricultural markets at below the cost of production. Additionally, immediate steps should be taken to develop and implement international rules and programs to end dumping worldwide.

7. Countries should defend themselves against dumping. Until dumping is effectively curtailed worldwide, all countries should retain and exercise their sovereign right to prevent the dumping of any agricultural commodity into their domestic market at below the cost of production through tariff rate quotas, countervailing duties or other border controls. Without an effective total worldwide prohibition on dumping, complete deregulation of borders makes it impossible for countries to maintain effective supply management programs, which paradoxically represent one of the most effective policies for ending dumping.

8. Forge an agreement on viable calculations for worldwide cost of production. A critical first step necessary to ban dumping is the conclusion of a worldwide agreement on a method for calculating the cost of production of sugar and other commodities in fair and equitable manner for all countries. In June 2004, the United Nations Conference on Trade and Development created a commodities task force which could provide an immediate forum for such negotiations. Alternatively, the WTO should also take up the challenge and develop new rules for calculating the cost of production and ban all dumping based on such rules.

Appendix A: U.S. sugar program: No dumping, no taxpayer subsidies, no kidding

The 2002 Farm Bill establishes three pillars of the U.S. sugar program, which are used to meet a congressional mandate to manage domestic production, domestic inventories and sugar imports in a manner that provides both U.S. and foreign sugar producers with a price above the cost of production from the marketplace. To the maximum extent possible, Congress has mandated the U.S. Department of Agriculture to administer the sugar program at no cost to taxpayers. The three pillars are the **non-recourse loan program**, **marketing allotments** and **tariff-rate quotas**.

I. Non-recourse loan

The USDA administers the non-recourse loan program through a government entity called the Commodity Credit Corporation (CCC). The loan is described as "non-recourse" because the program allows sugar processors to pledge sugar as collateral for the loan at a price legislated by Congress and requires the CCC to accept sugar in lieu of cash as payment for these loans at maturity. Unlike most other commodity programs, the sugar program requires the USDA to make non-recourse loans to sugar processors rather than directly to sugar farmers. This is required because sugarcane and sugar beets are perishable and must be processed into sugar before being stored or shipped. However, processors must agree to share loan awards with producers in order to qualify for these loans.[52]

The amount and value of the sugar accepted by the CCC is determined by the federally legislated price per pound which is based on past years' production, estimated domestic consumption, inventory reserves on hand and other factors. The current legislative price in the 2002 Farm Bill is 18 cents per pound for domestically grown cane sugar and 22.9 cents per pound for domestic refined beet sugar. The difference in the loan rate for raw cane and refined beet sugar reflects the higher cost of processing beets to a refined, or consumer-ready, state. The program also provides loans to processors for "in-process" sugars and sugar syrups at 80 percent of these established loan rates. The maximum term for a CCC non-recourse loan is nine months and the loan must be paid back with interest by the end of the fiscal year in which it was issued. This allows the program to pay for itself with no need for the massive taxpayer subsidies found in other major U.S. commodities.[53]

If the domestic market price for sugar falls below the legislated loan rate established by Congress, CCC must accept sugar in lieu of money for repayment of the loan with interest. This mechanism allows processors to avoid selling sugar at a loss when the market price is below the established loan rate and, instead, at least break even by paying off their loan with the sugar they produced. As the processors forfeit their sugar, CCC holds sugar off the market in reserve, thereby reducing supply and raising the market price. When the market price exceeds the forfeiture level (the loan rate plus interest and some transportation costs), the processors return to selling on the market because they will make more money at the higher price than they would by forfeiting the sugar to CCC. In this manner, the non-recourse loan program attempts to set a *price floor* for the domestic market that stabilizes the market price over time, unless other factors—such as too much domestic production or increased imports—intervene.[54] But the program only provides an effective floor for sugar placed under loan. Although the government takes ownership of the sugar when

forfeited, processors must store the forfeited sugar themselves, even though the government does pay processors some storage fees. However, storage capacity is limited and so not all sugar can be placed under loan and forfeited. For example, in the price disaster year of 2000 when marketing allotment authority was not in place and sugar market prices fell by about 30 percent, only about 10 percent of the crop was forfeited. Much of the sugar was sold well below forfeiture levels.[55]

II. Marketing allotments

The sugar program avoids overproduction and costly surpluses by giving the secretary of agriculture the authority to limit domestic sugar sales through flexible marketing allotments assigned to processors at a level that matches their allotment with projected domestic demand. Beet and cane planting and sugar production are not restricted; only actual sales of sugar. If processors produce more than their allotment, they must store the excess at their own expense. Allotments are another management tool that allows the secretary of agriculture to limit domestic sugar sales to the point where the market price remains high enough for sugar processors to meet their production costs and pay back their non-recourse loan with interest. By limiting production and supporting the price of sugar in the market, allotments allow the government to avoid the cost of storing the excess production that would otherwise be forfeited to CCC if the market price falls too far.[56] Another disincentive against overproduction is that if processors produce more sugar than they are allocated, the secretary can block them from selling such excess production on the market and require the individual producers who overproduced to store such excess reserves at their own expense.[57]

The marketing allotments for domestic processors is established each year by a formula that:

1. Meets U.S. commitments to accept 1.39 million metric tons, raw value of imported sugar under existing trade agreements (WTO and NAFTA).

2. Estimates the coming year's domestic demand for sugar for food consumption.

3. Takes into account carryover stocks from the previous year's sugar crop.

4. Assures a reasonable carryover of sugar reserves for the next year.

The secretary projects how much sugar will be consumed as food in the upcoming year which includes a reasonable carryover reserve for the following year. Then the secretary subtracts existing inventory from this total consumption estimate and subtracts the 1.39 million mt of imports that the United States is obligated to accept under formulas negotiated under trade agreements, e.g., the Word Trade Organization (1.139 million mt) and NAFTA (250,000 mt). The remaining share of total domestic production is then allocated between refined beet sugar (54.35 percent) and raw cane sugar (45.65 percent). Because Congress mandates the program to operate at no cost to the taxpayer to maximum extent possible, the secretary is granted some flexibility to reassign the allocations for a variety of reasons during the crop year in order to meet this goal.[58]

For fiscal year 2005 (Oct. 1, 2004-Sept. 30, 2005), USDA established the overall allotment quantity (OAQ) at approximately 7.35 million mt. The OAQ is calculated by subtracting alternative sources of sugar supply (known as non-OAQ sources) from the projected domestic consumption of sugar used as food.

Table 4. FY 2004-05 USDA overall allotment quantity[59] (in millions of metric tons)

Total projected use for food		8.8
Ending stocks		2.0
		10.8
Less non-OAQ sources		
Imports	(1.4)	
Carry-over stocks	(2.0)	
		(3.4)
OAQ		7.4
Beet sugar allocation (54.35%)		**(4.0)**
Cane sugar allocation (45.65%)		**(3.4)**

Marketing allotments and the non-recourse loan eliminate domestic overproduction, thereby relieving economic to pressure to dump sugar onto the world market at below the cost of production and curtailing downward pressure on the world market. This is in stark contrast to the other major U.S. commodities like corn, soybeans, wheat and cotton, which overproduce, dump onto the world market at below the cost of production, and require massive direct government subsidy payments to make up some of the difference between low market price and cost of production.

The amount of domestic consumption allotted to U.S. sugar producers hinges pivotally on the amount of imported sugar allowed into the domestic U.S. market for sugar consumed as food.

III. Tariff-rate quotas

The third pillar of the sugar program is a tariff-rate quota (TRQ) system, which the United States has historically used to control sugar imports. It is a two-tiered system that allows 41 countries to export into the U.S. specified quantities (quotas) of sugar at a lower, nominal tariff rate than usually applies, thereby ensuring a certain minimum access—currently about 13 percent of U.S. consumption—to the U.S. market despite otherwise high tariffs. Countries are allowed to export sugar to the U.S. above their specified quota, but only at the substantially higher tariff rate.[60]

While the non-recourse loan and marketing allotments keep U.S. domestic sugar production in check, the effectiveness of the entire program depends on preventing imported sugar from exceeding a point where it creates an oversupply on the domestic market and thereby collapses the domestic price below the non-recourse loan rate set by Congress (see section I, above). If too much sugar was imported, the domestic market price would fall below the non-recourse loan rate. In order to avoid incurring a loss by selling sugar at the lower market price, processors would stop selling their sugar production on the market, and instead begin forfeiting their sugar to the government-owned Commodity Credit Corporation to repay their non-recourse loans in order to break even. This would create unmanageable sugar stock reserves and increased storage costs for the government, thereby defeating the congressional mandate to administer the program at no cost to taxpayers to the maximum extent possible. Falling domestic prices would thwart proces-

sors—and by extension, farmers—from receiving a fair price from the marketplace, eventually forcing them out of business or forcing Congress to supplement the market price with direct government subsidy payments like other U.S. commodities.

The TRQ system is an essential inventory management tool designed to restrict imports enough so that they don't undermine the domestic inventory management tools (the non-recourse loan and marketing allocations), while still allowing limited market access to importers in order to satisfy U.S. commitments negotiated through trade agreements. Without TRQs or some other type of border management, domestic supply and inventory management would be impossible for any crop that can be imported from abroad in large quantities at below the cost of production. Without effective supply management, the economic pressure to dump most of the world's major commodities onto the world market cannot be relieved. This is why eliminating subsidy payments alone cannot stop dumping. Together these three supply and inventory management pillars—non-recourse loan, marketing allocations and TRQs—allow the U.S. sugar program to avoid dumping as well as avoid the increasingly unpopular direct government subsidy payments that have become the norm in other major U.S. agricultural commodity programs.

Appendix B: DR-CAFTA: Regional versus multilateral trade negotiations

During the last three decades, global economic integration has increased significantly. In much of the world, a relatively narrow definition of economic management has been used to transform the role of the public sector and to rewrite trade and investment law. Substantial differences in countries' domestic situations—varying resource endowments, geography and degrees of political integration—mean that each country is affected differently by changes in trade rules. History has shown that, particularly for developing countries, it is important to maintain some policy autonomy to allow governments to forge trade policies that meet their needs. However, the complexity of pursing sustainable development that benefits the majority of people in the context of global integration as currently defined is daunting.

The debate over regional integration initiatives like DR-CAFTA versus comprehensive, multilateral trade liberalization such as that overseen by the WTO is particularly relevant for countries that face underdevelopment and slow economic growth. Although some economists assert that the multilateral pursuit of free trade can benefit small countries through comparative advantage,[61] developed countries are also exerting strong pressure on many developing nations—both politically and economically—to sign regional integration trade agreements like DR-CAFTA.

On the one hand, regional trade agreements are an important component of the world trading system. Examples such as the integration of Western Europe into the European Union and the linking of Caribbean countries in CARICOM, show that regional agreements offer important benefits to their members. These benefits include access to larger markets; allowing economies of scale and more efficient use of resources; technology transfer; and avoiding expensive and redundant duplication of knowledge. Unions of this kind can also strengthen member countries in their multilateral negotiations, allowing delegations to divide up the work and to be heard with greater force.

On the other hand, regional integration can also be problematic for the countries involved. The problems are especially acute when the powers are not well-matched for political and economic strength. NAFTA is an example of a problematic treaty, where both Canada and Mexico are far more dependent on their trade with the U.S. than the U.S. is on its trade with either other partner. Moreover, the treaty ignores social issues (unlike the European Union's treaty) and makes no provision to address the vast social and economic disparities that separate Mexico from either other partner. There is no provision for the free movement of labor, for example, although economic theory requires this mobility to ensure the markets behave as efficiently as predicted by models. As a result, the treaty has been shown to create downward pressure on working conditions and environmental standards. At a political level, when a Goliath such as the U.S. negotiates with much smaller states such as those of Central America, whose trade with the U.S. overwhelms trade with any other country, there is no basis to ensure a fair and equitable outcome. At the same time, countries that do not join the treaty risk forgoing trade, as the regional treaties are likely to divert trade away from non-members towards other members. This makes it difficult for a small neighboring country to justify staying out of the agreement—especially if the majority of their trade is with one of the countries concerned.

Proponents of regional integration initiatives such as the proposed DR-CAFTA suggest that such prefer-

ential trading arrangements are, in fact, "building blocs" toward multilateral liberalization.[62] Such proponents argue that the continued trade barriers faced by countries not included in the regional initiative will eventually be phased out in the interest of a global system of free trade as participating countries rationalize their production and become more competitive.

On the other hand, Supachai Panitchpakdi, recently the Director-General of the World Trade Organization, cited a new report indicating that 21 bilateral and regional trade agreements have been notified to the WTO between January and August 2004 alone, putting the total number of such agreements at over 200 worldwide. The report warned that this trend towards such agreements expands preferential and discriminatory trade relations to the point of becoming "an ever more established and perhaps irreversible feature of the international trading system." Panitchpakdi expressed alarm that this trend represents a "significant challenge" to the multilateral trading system.[63]

For decades advocates of trade liberalization have argued that the best way for developing countries to overcome poverty is to open domestic markets to unfettered imports in exchange for better access to developed countries' markets while rejecting other approaches to development—especially those approaches that acknowledged the importance of linking agriculture to development.[64] However, practice has proved much more confused than the theories predicted. Developed countries have been reluctant to open their markets and instead have only selectively created new market opportunities for developing country exporters. Meanwhile, some countries have fared well by focusing on an export strategy for growth, but many others have failed. In any case, the rules keep evolving, changing the nature of the opportunities (and risks) involved. For example, most of the world's poorest countries (the 50 or so categorized as least developed countries by the UN) are now coping with what is described as a "post-liberalization" context: Their economies are in most respects more open than those of developed countries and the result has been dangerous destabilization.

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