ECN230 Case Studies on Trade Issues: On Distortions from Sugar Policy

US and EU Sugar Programmes Distort Trade

Powerful lobbies ensure that US sugar industry remains heavily protected

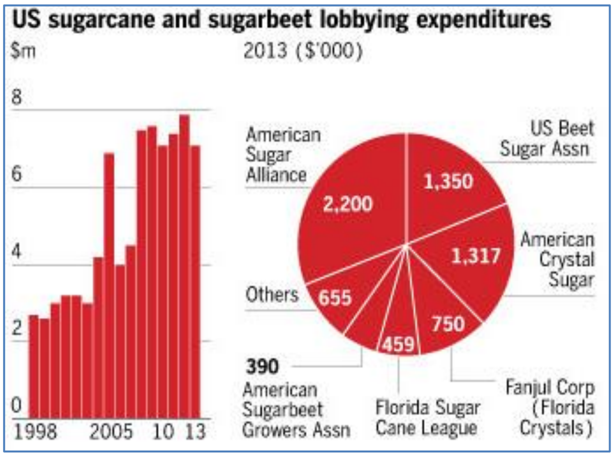
The US government's vast assets include office buildings, mineral resources, aircraft carriers and national parks. In 2013, it added mountains of sugar. Warehouses from North Dakota to Louisiana were piled high with 296,500 tons of the sweet crystal, since October 1 the property of the Department of Agriculture. The agency said it planned to sell off its stocks at a "substantial loss per pound". Sugar has cost taxpayers $278.2m in 2013 [1].

In an age of spending cuts, the unusual transfer into the government's reluctant hands was an embarrassment for backers of US sugar policy, which was meant to keep domestic prices higher than world sugar prices without costing taxpayers a dime [1].

The programme, in place since 1981, was up for debate in Congress as part of the farm bill, which is negotiated every five years. "We're hoping to keep our friends with us. It's been a tougher sell, but we aren't done yet," says Paul Rutherford, who grows sugar beet on 550 acres in Minnesota. Although political support for protecting sugar has waned, Mr Rutherford had no immediate need to worry. Even as food subsidies for the poor and payments to grain farmers faced cuts, there was universal agreement that sugar should stay protected [1].

The survival of a programme that supports fewer than 5,000 US sugar farms testifies to the clout of small but intensely focused industry lobbies in Washington. The American Sugar Alliance, one such group, spent about $2.2m 2013 alone (see chart, US sugarcane and sugarbeet lobbying). It also illustrates the difficulty of adhering to free-trade principles in a commodity that is heavily subsidised around the world. Despite protectionist measures, the US sweet tooth required millions of tons of raw sugar imports – imports that led to government sugar purchases in 2013. Protection of sugar would be a sticking point in the Trans-Pacific Partnership trade talks that took place between the US and 11 other nations [1].

The US sugar industry unites an alliance of growers from the far south and north of the country. Cane interests are concentrated in Florida and Louisiana and include groups such as the politically influential Fanjul family, which rebuilt a sugar dynasty in the US after fleeing Fidel Castro's Cuba. Sugar beet are rotated with grain and soyabeans beside the oxbows of the Red River between Minnesota and North Dakota [1].



Cane and beet tend to rot. On the shores of Florida's Lake Okeechobee, west of Palm Beach, this means cut cane must be processed quickly at nearby mills. The Red River valley's brutal winters are an ideal climate for storing beet outdoors in 1,000ft piles, allowing processors to run at full capacity for several months. The overnight temperature at the Moorhead, Minnesota, headquarters of the American Crystal Sugar beet co-operative can plunge to below minus 14C. "We don't complain when it's cold," says Mohamed Khan, sugar beet specialist at the universities of Minnesota and North Dakota State [1].

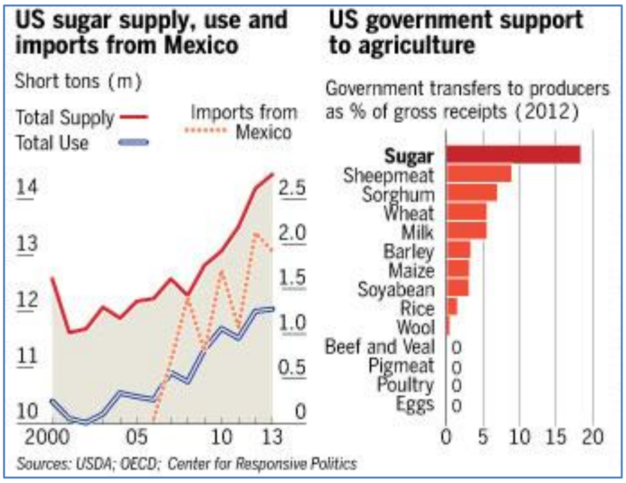
The problem of spoilage differentiates sugar from commodities such as corn and soyabeans, which farmers can hoard in bins until prices favour a sale. Cane and beet must be processed into crystal sugar before it can be traded and stored. Recognising this fact, the US sugar programme is aimed at processors, not individual farmers. While grain farmers receive direct government payments and subsidised crop insurance, the US sugar programme "supports US sugar prices above comparable levels in the world market", the USDA's economic research service says. The law outlines a uniquely top-down approach to achieving this goal [1].

First, the USDA makes marketing loans to processors at a fixed value per pound of sugar. If sugar prices fall below this value, processors are at liberty to hand the government collateral in the form of sugar instead of repaying cash. Second, to avoid loan defaults, Tom Vilsack, the USDA secretary, declares how much each processing company may sell into the domestic food market, much as Opec rations oil output. The 2013 quota of 9.8m tons was allocated with precision, from 940,017 tons for the Fanjuls' Florida Crystals to 371,529 tons for the Minn-Dak Farmers Cooperative of Wahpeton, North Dakota. Companies exceeding quotas faced a penalty three times the value of their illicit sales [1].

The elaborate plan crafted in Washington each year filters down to individual farmers. At American Crystal Sugar, contracts with its roughly 2,700 farmer-shareholders to determine how many acres each must plant every year. Farmers pledge to plough under any surplus beet. "When you become a shareholder you have to provide a certain amount of sugar beet to the factory. If you don't, you will be fined," says Mr Khan [1].

The third prong of the sugar programme restricts imports. Mr Vilsack, former governor of the farming state of Iowa, dictates how much raw sugar from a list of 40 foreign countries including Brazil and the Philippines may enter the US with low tariffs, regulating supplies. The US is not alone in protecting sugar. Economists dub sugar, rice and milk the "rice pudding commodities" for their heavy government support. In Japan, government transfers comprise more than half sugar farms' gross receipts while in the US they are 18 per cent, according to the OECD (see chart on sugar supply and US government support) [1].

The USDA's painstakingly managed system was now unravelling. As US supply surged to 14.2m tons in the year to September 30, 2013, domestic sugar prices fell and forced officials to scramble to prevent defaults by processors. In the same period, only 12m tons were used, making Washington's attempts to balance supply and demand increasingly fraught [1].



Despite official efforts, processors forfeited 85,375 tons of sugar valued at $34.6m for loans due in August. On the eve of the federal government shutdown at the end of September they handed over another 296,500 tons worth $136.9m. The second batch is now heaped in borrowers' warehouses at a cost of $575,000 a month as the government searches for a buyer [1].

American Crystal Sugar surrendered nearly 100,000 tons instead of repaying $46.6m. "Ultimately we chose to forfeit some sugar under the programme, which is an unfortunate situation, given the poor market that we're operating in. But that's what the programme is for and that's why we utilised it the way we did," says Kevin Price, director of government affairs at American Crystal [1].

The main reason for the disarray is the collision of the 32-year-old sugar programme with a separate policy: the 1994 North American Free Trade Agreement among Canada, Mexico and the US. The pact took effect for sugar in 2008, allowing Mexico to export virtually unlimited amounts. Mexican imports were forecast to continue flowing in 2013, pushing the US oversupply ratio to its highest level in 13 years (see left-hand-side of chart) [1].

The sugar programme is so entrenched that a permanent lobby group exists to reform it. The Sweetener Users Association (SUA), backed by sweet and food companies such as Mars and Mondelez, was founded in the early 1980s. "The thing they always were able to say is, 'it doesn't cost money'," says Tom Hammer, who led the SUA in the 1990s [1].

As 2013's defaults undermined that argument, the coalition of programme critics expanded in Congress. A House of Representatives proposal that would have reformed sugar policy failed 206 to 221 in October. Six years earlier, an amendment that would have ended the sugar programme failed 144 to 282, a vote that showed much greater support for the status quo. In the Senate, a vote in 2012 to phase out and ultimately abolish the sugar programme won the support of 46 senators, with 50 voting to quash it. Eleven years earlier, 71 senators voted to kill an almost identical measure. "That strikes me as significant progress," says Pat Toomey, a Republican from Pennsylvania and advocate of ending the programme [1].

When the US signed a trade deal with Australia in 2004, sugar was excluded. Australia wanted the US to open up its sugar market more as part of the TPP negotiations, according to Bill Reinsch of the National Foreign Trade Council [1].

The sugar industry's power is magnified in Congress by alliances with agriculture organisations. The US Farm Bureau Federation and National Farmers Union, two broad lobbies, both support the sugar programme. The sugar industry is "effective at working with other commodity groups. They scratch each other's back," says Gary Blumenthal, head of World Perspectives, an agriculture consultancy in Washington [1].

For some businesses, the sugar policy is an intractable obstacle. Jelly Belly, the US maker of gourmet jelly beans, in 2006 opened a factory in Thailand when it expanded international operations in part because of US policy, says Bob Simpson, company president. The sugar industry argues the support is crucial in the face of protected competition abroad. "It's in the public interest, it's in the national security interest and it's in food safety interest that the US is able to feed itself and not be dependent upon foreign countries for food supplies," says Judy Sanchez of US Sugar, which grows cane on 160,000 acres in Florida [1].

Growers also point out that US raw sugar prices, averaging 21 cents per pound in fiscal year 2012, were cheaper in nominal terms than when the programme began. The US price was also only a few cents higher than comparable world prices, shrinking from almost 15 cents a decade ago. And while the wholesale US sugar price plummeted 35 per cent in the past year, consumers paid only 2.7 per cent less for sugar and sweets [1].

"US sugar prices are now lower than they were on average in the 1980s. We have a lot of farmers whose economic existence is in jeopardy," says Jack Roney, chief economist at the American Sugar Alliance [1].

As he stood on the floor of the House o speak against reform of the US sugar programme, Collin Peterson, a Minnesota Democrat whose district includes the Red River valley, painted a grim picture. Far from engineering a "fat cat" deal at the expense of taxpayers, Mr Peterson lamented that the US was doing far more to "help other countries" by allowing huge sugar imports [1].

"I invite you to come to American Crystal's meeting in December [2013], where they are going to be reporting that they've lost money this year," Mr Peterson said. He offered a warning to reformers: "I can guarantee you if you get rid of the sugar policy what you are going to have is a feast or famine situation and you might have low prices for a while but you are going to have a time when you have high prices that are going to do a lot more harm to you than the sugar programme does" [1].

EU lifts sugar production quotas

After years of absence from the world sugar market, the EU sugar sector was expected to become a leading player after Brussels lifted sugar production quotas in 2014, eliminating the guaranteed price for sugar beet farmers and abolishing export limits [2].

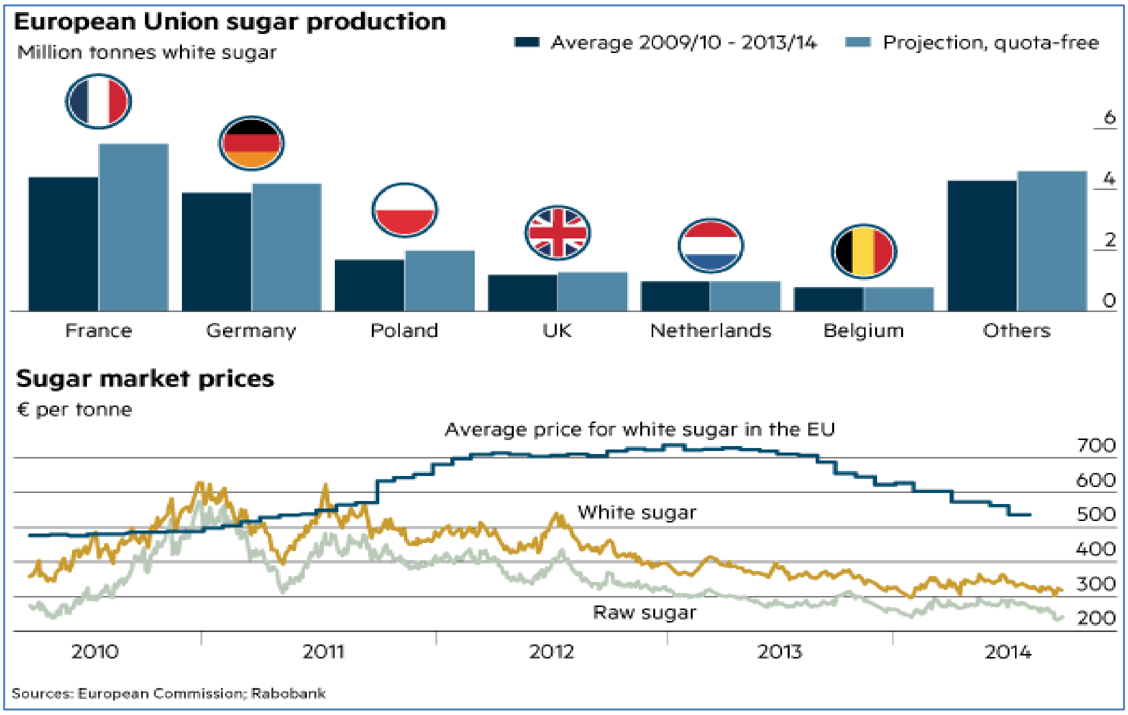
Even by their own admission, not many sugar traders think about events beyond a week. But the big shake-up for European sugar in 2014 was one of the most hotly debated topics during the London Sugar Week. Traders were pondering the changes in flows of sugar as the world's third-largest producer and second-largest consumer re-entered the international market. "Our timescale [for trading] is normally about five days but these are big changes," says one leading sugar trading executive [2].

Europe has been a minor player on an international level ever since Brussels implemented EU sugar policy reforms in 2006 after claims of sugar dumping by the World Trade Organization. Brussels imposed production quotas allowing beet sugar to supply 85 per cent of demand and the EU changed from being the world's second-largest sugar exporter to a net sugar importer [2].

The changes in 2014 would mean that production was likely to increase as output caps were lifted, leading to the excess sugar being exported. "European production will become a very important factor influencing the world market," says Robin Shaw, a sugar analyst at commodity brokers Marex Spectron. According to EU data, the region's countries produced just under 17m tonnes of beet sugar in the 2013-14 crop year and sugar experts believed that production could rise 15-20%, post-2017. Ruud Schers, an analyst at Rabobank, the Dutch lender, saw production growing 15% after the production quotas were lifted and believed that France had the highest potential in growing output. He forecasted French production rising 25% to 5.5m tonnes (see chart, EU sugar production) [2].

beet. The additional supply of white refined sugar from the EU is likely to depress international white sugar prices, pressuring margins for refiners around the world. "The post-2017 world is bearish for all refiners," says Mr Shaw [2].

Europe's beet processors will face competition from refiners in the Middle East and north Africa, its main markets before export restrictions were put in place. There is a lot more competition from refiners in countries such as Algeria, Saudi Arabia and Dubai's Al Khaleej, the world's largest refinery, says Claudiu Covrig, an analyst at sugar consultants Kingsman. The market will especially be tough for sugar cane refiners in the EU, which need to import their raw materials from outside the region as there are no plans to dismantle the current import restrictions on raw cane sugar [2].



The expected lifting of the EU's 1.37m tonne export limit in 2017 and higher production would mean that the region could become a "swing producer" in the sugar market. European sugar is produced from beet, an annual crop, as opposed to cane, grown in many of the tropical countries and which has a plant production cycle of about four to five years. This will mean that European farmers will be able to respond quickly to price rises and falls, and hence could act to stabilise a potentially volatile market, says Mr Shaw [2].

"You could have situation where if prices were really bad, production could fall to 13m tonnes and, if they were high, rise to 22m," he says. The changes would benefit beet growers who are cost-efficient and can scale up their production to produce sugar at competitive prices. However, uncompetitive growers with higher costs, especially those in southern Europe, could be forced out of production [2].

The lifting of output quotas for isoglucose (also known as high fructose syrup) by Brussels would also mean increased competition in the European sweetener market, leading to consolidation. Another segment of the sugar industry that will be hit by Europe's return to the market are the refiners [2].

While much of the sugar traded in the world is raw cane sugar exported by leading producers such as Brazil and Australia, Europe trades white refined sugar made from

Apart from certain developing countries with duty-free access, EU imports from countries with bilateral trade agreements have faced an additional tariff of €98 a tonne while importers have had to pay €339 a tonne for other purchases. Cane processors, such as the Tate & Lyle Sugars refinery in London, are expected to continue to struggle under the current regime, and are lobbying for the import duties to be abolished as well as calling for new trade agreements with suppliers to be signed [2].

References:

[1] "Commodities: A sweet deal", *Financial Times*, by Gregory Meyer and Stephanie Kirchgaessner, 15 Nov 2013, p. 7.
[2] "Europe's comeback set to shake up sugar", *Financial Times*, by Emiko Terazono, 16 Oct 2014, p. 26.