

U.S. Agricultural Trade under a Liberalized Trade Environment
Sugar: Industry Perspective
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Introduction:

I come to you today representing a successful and progressive United States sugar industry. We are most certainly not an industry without challenges—what company growing or selling commodities does not have challenges? Still, I think that my company, American Crystal Sugar Company, and the rest of the domestic sugar growing and processing industry, can be proud of progress that we have made in many important areas.

I do not try to fool myself as to why sugar is on the program at this conference. In some people's minds, perhaps even Dr. Orden's, sugar is the "poster child" representing the need for urgent trade liberalization. I could not agree more. My approach today will be to describe for you the US and world sugar industries, and then to discuss why true trade liberalization is urgently needed. I will then close with a couple of philosophical points related to the theoretical basis for free trade.

U.S. Sugar Industry:

Let's start with a very brief overview of the United States sugar processing industry. The areas in green represent sugarbeet production. Sugarcane production is shown in red. Corn production is centered in the yellow areas. The various dots and stars represent manufacturing locations. Along the coasts of the country, there are ten raw sugar refineries. As you can see, the sweetener industry is geographically diverse, and is important to the economies of many U.S. states.

While sugarbeets and sugarcane do not rise to the level of the major program crops in terms of planted area or volume, they still represent a significant economic contribution in the 16 states where they are grown and processed. Sugarbeets are

produced in 12 states, and a total of 88,000 people are directly employed in processing and marketing of the crop. Sugarcane is raised in four states. 72,000 people earn their living from turning cane into refined sugar. A significant related industry is the corn sweetener industry. A total of 750 million bushels of corn were processed into corn sweeteners last year, consuming about eight percent of US production.

Another important dynamic in the US sugar industry in recent years has been the purchase of a large portion of the industry's capacity by beet and cane growers. As you can see by the chart, in 1999 about one-third of the industry was grower owned. In just four years, we are approaching three-quarters grower-owned. A couple of large transactions accounted for much of this change, as a single European parent divested major beet and cane sugar operations in the US. The underlying fact is that returns in sugar processing in the US have been flat or non-existent, and have caused major owners to depart the industry. I believe that it is also significant that growers wish to keep the processing assets in production and available as an outlet for their crops. This is a reflection of the history of the sugar industry, in that once a mill goes out of production; it typically does not come back.

In addition to the dramatic changes in ownership, 20 processing mills have closed since 1996. In most cases, these closings have been the result of consolidation of volume within larger facilities. However, there are a number of examples of whole regions simply going out of sugar processing due to margin pressures. Consolidation has only been a small part of the US industry's drive for efficiency. Based on a long-term, comprehensive cost survey of all countries that produce sweeteners in the world, the US stacks up very well. The US beet sugar industry is second lowest cost in the entire world

out of 40 countries that produce beet sugar. We follow only Chile, which produces a very small fraction of what is raised in the US. The cane sugar industry is 26th out of 63 countries in terms of cost competitiveness. The fact that the US corn sweetener industry is the most efficient in the world is not surprising, as the process of deriving high fructose syrups from corn was invented in the US and also because we have a very low cost supply of starch in the Midwest corn crop.

The bottom line is that the US total sweetener supply is 21st out of 112 countries in the world in terms of cost competitiveness. Keep this thought in mind as we move ahead with the discussion.

I will summarize quickly my main points about the U.S. industry:

- It is competitive in terms of production cost with sugar producers around the world.
- Sugar production is capital intensive on the farm and especially in processing raw material beets or cane.
- Ownership of these production assets has gone through a dramatic restructuring in recent years, reflecting poor or absent margins.

U.S. Sugar Program:

I will also spend a few minutes reviewing the essentials of the U.S. sugar program. There are three main components to the program. Sugar processors may use non-recourse price support loans. The loan rate for raw cane sugar is 18 cents per pound, and the rate for refined beet sugar is 22.90 cents. The cane loan rate not changed since 1985.

USDA protects against loan forfeitures by using a Tariff Rate Quota. There is a floor which equates to approximately 15 percent of domestic consumption mandated under the Uruguay Round. The TRQ is spread among 41 quota-holding countries which have been historical suppliers of sugar to the U.S. market. The majority of these countries have been strong supporters of the U.S. sugar program, as it has provided to them a guaranteed share of a premium market.

A final and very important feature of the sugar program is Marketing Allotments. The Allotment system had also been used under the 1990 Farm Bill, were taken out in 1996, and returned in 2002. The domestic sugar marketing allotment is determined each year by USDA to balance domestic marketings with anticipated usage and the level of imports required under the Uruguay Round agreement. The overall domestic marketing allotment is divided between the beet and cane sectors, and among various processors, under formulae written into the Farm Bill.

The good news about the sugar program is that it has provided producers with relatively stable prices over the past 20 years. As you can see by this chart, raw sugar prices (represented by the orange line) have been between 20 and 23 cents per pound for nearly all of this period. The excursion below 20 cents which began in 2000 was the basic impetus for re-imposition of allotments under the 2002 Farm Bill. Refined sugar prices have been somewhat more volatile. The green line represents refined prices in Chicago, which are primarily driven by beet sugar processors. The refined-over-raw differential is driven mainly by the size of the sugarbeet crop and availability of refining capacity in the cane industry. The current spread of 5.5 to 6 cents represents something approaching equilibrium. If the good news has been that producers have seen steady

prices for 20 years, the bad news is that producers have seen steady prices for 20 years. As you can see on this chart, flat nominal prices mean that sugar producers and processors have had to find efficiencies to offset almost 60 percent inflation in the cost of various inputs.

One of the criticisms normally targeted at the U.S. sugar program is that it supports prices above those available if we purchased all of our sugar in the world market. I will touch on some of the fallacies of the world market in just a moment, but I believe it's important to focus on how affordable sugar is to consumers in the United States, compared to other countries. The average retail price paid by consumers in a sampling of U.S. cities last year was 42 cents per pound. Compare that to 52 cents a pound in the average of 21 developed countries measured in this sample. It's also important to note that prices in Canada are 35 cents per pound, and 34 cents per pound in Australia. Neither of these countries restricts imports, so the often-cited benefit of purchasing sugar on the world market at 7 cents raw value does not translate itself into significantly lower sugar prices for consumers in those countries.

I would also like to spend a moment reinforcing the idea that the U.S. sugar program does not result in higher prices for sweetener-containing products. Opponents of the sugar program frequently cite the cost to consumers of paying prices in excess of what might be available in the world market. USDA data indicates that that cost is more illusory than real. The two orange bars on the left side of the chart indicate what has taken place in U.S. sugar markets between 1996 and last year. Raw sugar prices declined by almost 7 percent and refined sugar prices went down by almost 12 percent. Contrast that to what has happened in major categories of products containing large amounts of

sugar. Retail sugar prices rose by 3 percent. Manufactured product prices rose between 7 and 24 percent. The idea that consumers would benefit from cheaper sugar is simply not supported by the data.

Again, a recap of the most important points:

- The U.S. sugar program has been in place in essentially the same form for almost 25 years.
- The program retains a significant share of the U.S. market for exporting countries.
- After inflation, consumers have paid less and less for sugar for almost 20 years.

Sugar is a true bargain for Americans.

World Sugar Market:

Advocates of liberalized trade in sugar frequently point to the opportunities for lower sugar prices by importing a larger share of the U.S.' sugar supply. In order to test that assertion, we should spend a few moments going over the fundamentals of the world sugar market. World sugar production ranges from 130 to 140 million metric tons per year. At 8 million tons, the U.S. makes up about 6 percent of world supply. About one-quarter—35 to 40 million tons—of world production is exported. Ending stocks have run in a range of 30 to 35 million tons per year, or about a quarter to a third of annual consumption.

World raw sugar prices since 1985 have been as low as 3 cents per pound on a monthly average basis, and have risen to 15 cents. The volatility of sugar—moving from 3 to 15 cents and back below 5 cents over a decade—indicates that there are influences

beyond simple crop fluctuations at work. In fact, sugar is one of the most heavily subsidized commodity markets in the world.

Essentially every country that produces sugar somehow intervenes in its domestic market. The list of ways that this is done is simply too long to even try to describe, but list includes export subsidies, import restrictions, direct producer subsidies, and many kinds of less-than-transparent benefits that flow from governments to producers. As I said earlier, about 25 percent of world supply is exported, meaning that three-quarters of supply is consumed in its home market. The cost of producing sugar plus some acceptable profit margin are covered on sales of sugar in the home country. Domestic prices are maintained at levels which allow this to occur. The balance is dumped into the world market.

Of course, it would not be accurate to say that every pound of sugar sold in world trade meets the technical definition of having been “dumped”. However, going through the ledgers of most exporting countries, you will find a pretty consistent theme. Some portion of most country’s marketings are sales into export of sugar that is surplus to domestic requirements. Because of the margin earned on higher-value domestic sales, the producer is indifferent to the price of the export sale. For this reason, the world sugar market provides an invalid basis of comparison for the efficiency of the U.S. sugar program or market.

Before you attempt to read this slide, please stop. The print is too small. I show it only to illustrate the breadth and the depth of intervention in sugar markets by a range of countries. Fourteen different countries are listed on this chart, accounting for 98

million tonnes of production, or about three-quarters of the world's output. Eight of the ten largest producers are included.

I've highlighted some particular practices just to illustrate my point that some degree of fiddling in the sugar market is almost universal. Six of these countries provide guaranteed support prices to growers. Thirteen out of 14 have an import tariff in place. Six provide direct income support, and six provide interest subsidies. Four have ethanol programs in place. Notably, the world's second largest producer and largest exporter, Brazil, has an extensive support mechanism for its ethanol industry. In many ways, sugar is a by-product of the ethanol industry in Brazil. Depending on oil prices and the domestic economic situation, Brazil can swing a major proportion of its infrastructure into or out of sugar production. The implications for world prices, and the cost structure of the Brazilian industry, are obvious.

The conclusion to be drawn from this chart is clear: Intervention in the economics of the sugar market is widespread, even among many countries that carry the banner for free trade in the world sugar economy.

I cannot state the case more succinctly than with these two facts: The average production cost for sugar between the 1984 and 1999 crop years for the entire world was 16.26 cents. The average price in the world market for the same period has been 9.5 cents. The world sugar market does not reflect the true economics of producing sugar. Its primary function is to provide an outlet for excess supply generated by various national industries attempting to utilize their capital infrastructure.

My concluding points on the world sugar market:

- Only a relatively small proportion of the world's sugar production leaves the country where it is produced.
- Most countries intervene, either transparently or non-transparently, in their domestic sugar markets.
- And most telling, the long term price of sugar in the world market is well below the average cost of production.

U.S. Sugar Position on Trade Liberalization:

Now, I will move to the real objective of today's discussion—how sugar fits into a more liberalized trade environment under a WTO or FTAA agreement. Trade Ambassador Zoellick and other members of the Administration have stated that their strategy is one of “competitive liberalization”. The goal is a more open trade environment. My interpretation is that Mr. Zoellick would be more than happy with a comprehensive agreement in the Doha Round of the WTO. It also seems to me that the Administration would also be happy with accomplishing the goal of liberalization through a series of bilateral agreements. The message seems to be that the free trade train is getting ready to leave the station. All those interested in participating had better get on board!

Mr. Zoellick has certainly backed up his strategy with concrete action. At the present, the U.S. has negotiated, is negotiating, or has discussed intentions to negotiate free trade agreements with the list of countries on the screen. We in the sugar industry do not believe that we are paranoid, but the countries on this list export 25 million tonnes of sugar per year, or about two and a half times what we consume in the U.S. Needless to

say, the topic of trade liberalization has the sincere attention of everyone involved in the U.S. sugar industry.

Somewhere within USTR, there may be a piece of paper that lays out the detailed negotiating strategy to get closure on all the issues within the current round of WTO discussions, as well as a point-by-point listing of what can and should be accomplished in the various bilaterals that are being considered. I would not pretend to know what exactly is on that paper. However, it is apparent from public actions that agriculture is a priority for most participants in the Doha Round. The list of market-distorting practices that I enumerated for you just a minute ago makes sugar a very obvious target for reform and liberalization.

Going after reform in sugar in the WTO framework is a worthwhile goal that the U.S. sugar industry has endorsed. We do have a very real concern about a strategy of playing the bilateral approach against the WTO negotiations. If the United States were to liberalize sugar trade with one or more of the partners with whom we are currently in discussion, we could lose the opportunity for real reform which is available in the Doha Round. The U.S. may accept unlimited imports under the FTAA or from a similar agreement with Australia. If this were to take place before the hard negotiations occur under the WTO talks, the U.S. will have essentially given up powerful cards in the broader negotiation.

If the goal is true multilateral progress in liberalizing world sugar trade, the place to get the job done is in the WTO. The piecemeal approach may open the U.S. sugar market to more competition, but it will also sacrifice the chance to dismantle the web of practices that have made the world sugar market so thoroughly un-economic.

To recap the sugar industry's position on trade talks:

- The U.S. sugar industry strongly endorses the goal of genuine free trade in sugar.
- The WTO talks, involving all countries and all practices is the place to make real progress in eliminating distortions in the world sugar market.
- The appropriate approach is comprehensive, sector-specific negotiations to approach the complex set of practices that currently hamper trade in sugar.

We are at a critical juncture in execution of the United States' trade strategy. To the extent that sugar is a sensitive item in this overall strategy, the sugar industry is on record that premature opening of the U.S. sugar market through bilateral agreements will—Expose U.S. producers, as well as any partner in the agreement, to subsidized sugar from other countries

It will also negate important leverage in the ongoing WTO negotiations.

Our message to Ambassador Zoellick and to previous USTRs, is that we should not unilaterally disarm. If liberalized agricultural trade is the objective, let's set the goal high and attempt to truly reform sugar—one of the very most distorted markets anywhere in the world trade environment.

Comparative Advantage – Theory vs. Reality:

I would like to conclude with a few more philosophical thoughts on trade. I don't need to remind you of the theoretical underpinning for comparative advantage. Adam Smith began the breaking apart of mercantilism with his admonition to buy our commodities from countries that can make them cheaper than we can. Applied to the

current world environment in agricultural trade, Mr. Smith's conclusion would be that developed countries such as the United States should allow production of many basic commodities to migrate to developing economies. We should in turn focus our resources on higher end manufactured products, technology, or services.

Allow me to provide you with my own practical reality to contrast to that admirable theoretical goal: The advantages of free trade will not accrue to market participants unless perfect competition exists within the various markets. In reality, industries as well as individual firms in this country and elsewhere enjoy market power which would allow them to exploit relaxation of barriers. No better illustration can be made than the relationship between raw sugar entering Canada seven cents per pound, and refined grocery sugar selling for 35 cents per pound in Canada. Where did the extra 28 cents of cost come from? I would offer that it comes from "imperfect competition". By moving resources from one industry that shrinks or dies after liberalization into another that may have better growth potential, whole blocks of an economy can suffer. In human terms, this means unemployment or underemployment for years or even permanently.

Finally, for centuries or even longer, governments have demonstrated real reluctance to give up their ability to provide for basic food needs. The reluctance may be based on real or irrational fears about food supply, cost, or quality, but these fears are a meaningful underpinning to agricultural policies around the world. Furthermore, if one country moves more aggressively towards open trade while trading partners drag their feet, the aggressive country may create for itself a chronic trade imbalance that can have serious long term implications.

To emphasize this point, I think it's valuable to restate some of the philosophical reasons why we have an agricultural policy in the first place. As we all know too well, agriculture cycles with weather, human decisions, and with the availability of technology. Governments frequently intervene in their domestic agricultural markets, to prevent collapse of the rural economy, and the individual farms which make it up. Equally important are the desires on the part of the consumer to have a secure food supply at a stable (and affordable) price. To conclude, then, I think that United States agriculture policy has been a consistent success. It has overcome every challenge put in front of it to deliver abundant supplies to domestic and foreign customers. In addition to being abundant, our food supply offers consumers incredible variety, quality and safety that the rest of the world wishes it could emulate.

Final food prices to consumers have been stable for decades, and the proportion of spending on food consumed in the home has been in decline for a long time. U.S. sugar policy, for all the attention that it attracts, remains a noteworthy element of a very successful U.S. agricultural policy.

Thanks, everyone, for your attention. I look forward to any questions which you might have after the panel.