Competitive Enterprise Institute

Issue Analysis

Is the U.S. Sugar Problem Solvable?

by Barbara Rippel, Frances B. Smith, and Ivan Osorio

April 13, 2006

Is the U.S. Sugar Problem Solvable?

by Barbara Rippel, Frances B. Smith, and Ivan Osorio, April 13, 2006

Executive Summary

The United States' sugar policy has a long history of supporting sugar producers, and the current system has its roots in the agricultural programs of the Great Depression. The policy has been widely criticized both at home and abroad for supporting a relatively small group of sugar producers at the expense of consumers, taxpayers, sugar-using industries, and the environment. The program relies on restricting sugar imports to keep domestic prices high, which especially hurts those developing countries that are low-cost producers of sugar. The artificially high price also provides incentives for domestic sugar producers to increase production into environmentally sensitive areas.

This paper explores the possibility of reform of the sugar program by considering other agricultural reforms at home and abroad. The cases examined are New Zealand's agricultural policy reform in the mid-1980s, changes to the United States peanut quota program through a buyout program, and the buyout program for tobacco quota holders in the United States.

The pressures for reform come from several sources. The desire to complete further regional and bilateral free trade agreements might require more sugar market opening "concessions" by the United States, especially if negotiations with low-cost sugar producers are to be completed. In addition, the timetable of the North American Free Trade Agreement (NAFTA) will allow more Mexican sugar imports in the near future.

The ongoing negotiations among the members of the World Trade Organization (WTO) to conclude the Doha Development Round revolve around agricultural policies. The United States and other industrial countries might have to provide better market access for developing countries to complete the Doha Round.

The debate over the upcoming 2007 farm bill will highlight the need for reform of several costly agricultural programs, and while the sugar program has escaped significant changes over the last few decades, this is not guaranteed in the future.

The examination of three reform experiences in other areas provides some insight into possible options for sugar reform:

- **Agricultural reforms in New Zealand, which opted for a "shock reform" that left farmers little time to adjust to the new policies.** While difficult for many farmers, the reforms did not lead to the collapse of the agricultural sector, as some had feared. In contrast, agricultural production has thrived over the past two decades.

- **The buyout program for peanut quota holders enacted after the 2002 Farm Act.** The changes abolished a two-tiered price system under which quota holders were guaranteed a minimum price of $610 per ton, while other producers received a minimum $132 and were restricted from selling in the domestic market.

- **The compensation of tobacco quota holders through a buyout program.** This was enacted after tobacco reform abolished the existing tobacco quota and price support program.

These cases represent examples of the possible reform scenarios for sugar: the quick dismantling of the existing sugar program or a buyout option.

The conclusion that might be drawn is that, to be successful, reform needs to address several concerns, such as reducing the high costs for consumers and the sugar-using industries, as well as providing a long-term policy framework for sugar growers.

Reform efforts have been unsuccessful for decades because sugar producers could consistently muster enough political support for their political allies to block significant domestic changes. However, pressure for reform has not only arisen from criticism inside the United States but also from outside—for example, progress in liberalizing trade in other areas puts pressure on agriculture to follow suit; bilateral trade agreements with neighboring countires open up the U.S. markets, therefore increasing demand to provide poorer countries with better chances to participate in the world economy.

I. Introduction

The United States' sugar policy has been widely criticized both at home and abroad for supporting a relatively small group of sugar producers at the expense of consumers, taxpayers, and Americans working in sugar-using industries. In addition, sugar production in the United States has left its mark on the environment. The earlier expansion of sugar cane production into Florida's ecologically sensitive Everglades, for example, now requires an expensive cleanup, with taxpayers footing much of the bill.

Many developing countries have criticized the United States—and other industrial countries—for the limited access they receive for their sugar exports. Several developing countries are among the low-cost sugar producers which could expect to gain a real economic boost from better access to the U.S. market.

However, despite these concerns and criticisms, U.S. policy makers have effected little change to the U.S. sugar program over several decades. Congressional farm bills have come and gone, but the basic system of support for sugar producers has not changed since the 1930s. In 1934, the U.S. Congress added sugar to the products covered under the 1933 Agricultural Adjustment Act, which provided producer support for several agricultural commodities.

Despite criticisms, U.S. policy makers have effected little change to the U.S. sugar program over several decades.

This paper explores the possibility of creating a feasible solution that addresses the concerns of the sugar program's critics, but might also gather enough support from reform-minded producers and members of Congress representing sugar-producing areas.

The United States is not the only country confronted with such a dilemma; therefore, a peek across the borders might provide useful lessons from other countries' approaches to agriculture reform. Those lessons might be helpful for policy makers in the United States. In addition, a look into reform efforts in the United States in other agricultural sectors can bring some insights into how to approach the sticky question of sugar reform.

Cases to be examined include:

- New Zealand's agricultural policy reform in the mid-1980s that discontinued agricultural subsidies and support programs and dismantled import barriers
- Changes to the United States peanut quota program through a buyout program
- The buyout program for tobacco quota holders in the United States

II. A Short History of the United States Sugar Program

The support and protection of sugar producers has a long tradition in the United States.[1] Sugar had been a controversial political issue even before the Declaration of Independence, when the British Parliament introduced taxes on sugar imports to the American colonies in the Sugar Act of 1764.[2] Nevertheless, shortly after gaining independence, the new United States of America reintroduced duties on sugar imports to pay its bills.[3]

However, the basis for the current sugar program was set during the Great Depression in the 1930s, when the United States enacted a variety of support programs to help farmers suffering from a dramatic drop in agriculture commodity prices. In 1933, Congress passed the Agriculture Adjustment Act, which provided producer support for several agricultural commodities; and in the 1934 Jones-Costigan Act, Congress added sugar to the commodities eligible for support. At that time, more than 80 percent of sugar produced in the continental United States came from sugar beets.[4]

Many of the program's main features have stayed in place since then, including price support for producers and import restrictions. With the exception of an interim period between 1974 and 1977—a time of high world market prices—the government has meddled heavily in the domestic sugar market.[5]

The reinstatement of sugar support in the 1977 Food and Agriculture Act introduced government loans, and the government started buying up surplus sugar from producers. Subsequently, legislation in the 1980s and 1990s kept the system of sugar support alive.

Non-recourse loans, which allow growers to receive loans by pledging their sugar harvest as collateral, can be forfeited by sugar producers if domestic sugar prices drop below the loan rates, and the government has to accept the sugar instead of a cash repayment. The loan rates of 22.9 cents per pound for sugar from sugar beets and 18 cents for sugar cane establish a guaranteed minimum price for sugar producers.

The only option for avoiding forfeiture of the loans has been to prevent domestic sugar prices from dropping below the loan rates by limiting sugar imports and managing domestic sugar supply. Since the 1970s, U.S. sugar imports have dropped from more than 5 million tons to slightly more than 1 million tons per year.[6] Before the 1980s, about 45 percent of U.S. sugar for food consumption was provided from abroad; by 2003 it had shrunk to a mere 13 percent.[7]

In the 1995 World Trade Organization (WTO) Uruguay Round agreement, the United States committed to allow a minimum of 1.256 million short tons, raw value (1.139 million metric tons) of sugar imports per year under a new tariff-rate quota system. Under the quota system, 40 countries (plus Mexico) are allowed to export certain amounts of sugar to the United States on which they face only a negligible tariff rate.[8] Additional sugar brought in from a country already over the quota is targeted by a prohibitive tariff.[9]

The domestic part of the U.S. sugar program is administered through the U.S. Department of Agriculture's Commodity Credit Corporation (CCC), which, for technical reasons, provides loans to sugar processors instead of directly to the growers. In return, processors are required to provide sugar beet and cane growers with a payment proportional to the loan value of the delivered beets and canes.[10]

The Farm Security and Rural Investment Act of 2002 includes a requirement for the U.S. Department of Agriculture (USDA) to prevent—as much as possible—additional costs to the federal government by avoiding loan forfeiture by sugar producers.

USDA has used several measures to keep the sugar program from violating the "no-cost" provision. One such measure is to restrict imports of sugar through the quota system. But despite trade restrictions, USDA has not always been able to prevent market prices from falling below the loan rates. For example, in 2000 the government had to spend $54 million of taxpayers' money to buy 132,000 tons of sugar and remove it from the market to shore up domestic sugar prices.[11] In addition, USDA had to store thousands of tons of sugar in government warehouses when sugar producers decided to forfeit loans and transferred their sugar harvest, which is used as collateral, after prices had dropped below the loan rates. This storage cost taxpayers more than $1 million a month.[12] However, the 2002 farm bill changed that and instead required that growers themselves should bear the cost for storage. The bill does allow for taxpayer support for investments in upgrading and expanding storage facilities by sugar producers.[13]

So far, USDA has been able to avoid further forfeiture, partly because of a payment-in-kind program that allows sugar beet farmers to leave some of their land idle, and, in exchange for *not* harvesting all their planted sugar beets, receive sugar stored by the CCC. USDA used this mechanism in 2000 and 2001 to increase domestic prices for sugar by reducing the supply.[14]

Marketing allotments are another tool that USDA uses to regulate the domestic sugar market. Allotments, which were reintroduced in the 2002 farm bill, are a supply control mechanism by which USDA estimates the demand for sugar for the upcoming year and, based on previous marketing and other criteria, distributes among producers the share of the expected demand.[15]

The U.S. sugar program, having weathered many reform efforts over several decades, remains almost unchanged.

III. Pressures for Reform

The U.S. sugar program, having weathered many reform efforts over several decades, remains almost unchanged. Nevertheless, the pressure for reform is increasing from several sources. In addition to the domestic criticism over the costs for consumers, taxpayers, and the sugar-using industries, environmental groups have highlighted the sugar policy's negative impact on the environment. International aid organizations have criticized U.S. import restrictions that stifle the economic opportunities for developing countries, some of which are low-cost sugar producers.

Proponents of the program have been successful over the years in pleading their case for protecting the industry. In Washington, the "sugar lobby" is considered to be particularly influential. In recent international trade agreements, sugar producers have succeeded in preventing virtually any significant "concessions" by the United States of providing more market access for sugar importers.

3.1. Regional and Bilateral Trade Agreements

However, this invincibility might not be permanent. The passing of the Central American-Dominican Republic Free Trade Agreement (CAFTA-DR) last year, despite significant efforts on the part of sugar producers to block the agreement, could indicate a changing political atmosphere for the sugar industry.

The sometimes-heated debate over CAFTA-DR revealed a rift among different agricultural groups over trade agreements. Some agricultural producers, who hoped to benefit from more open trade, supported CAFTA-DR and other trade agreements.[16]

In 2004, the value of U.S. agricultural exports reached its highest level in history—at more than $61 billion, representing more than 16 percent of U.S. agricultural production, based on volume. Therefore, access to foreign markets is essential for U.S. agricultural producers.[17]

While the sugar producers were unhappy with CAFTA-DR, the agreement only allows at maximum an additional 107,000 metric tons of sugar imports in its first year. The amount will increase to about 151,000 metric tons over 15 years. This represents about 1.2 percent of current U.S. sugar consumption and 1.7 percent after 15 years.[18] Nevertheless, sugar producers saw it as a test case for future trade agreements with potentially large sugar exporting countries, such as Thailand and Brazil.[19]

The United States has started consultations with several countries on possible bilateral agreements, such as Thailand, and regional agreements with Andean countries—Colombia, Peru, Ecuador, and Bolivia.[20] Some of these countries are major sugar producers; excluding the U.S. sugar sector from further openings could become a major stumbling block for some of these agreements.

3.2. NAFTA Openings

The North American Free Trade Area (NAFTA) will fully open the U.S. sugar market to Mexican sugar imports after 2008.[21] While Mexico is a minor exporter at this point, the country's industry might develop more capacity in the future. The United States and Mexico are currently struggling to solve a dispute over U.S. high-fructose corn syrup (HFCS) exports. Mexico has tried to restrict imports through taxes on soft drinks using HFCS. Any significant replacement of Mexican domestic sugar for soft drink production by imported HFCS might free up capacities for exports of sugar to the United States. A recent decision by a WTO dispute settlement panel, after a complaint by the United States, against the Mexican beverage tax might force the Mexican government to remove import hurdles for HFCS.

3.3. WTO Negotiations

The debate over trade agreements will continue, because CAFTA-DR was only part of a series of ongoing trade negotiations—including the current efforts to conclude the World Trade Organization Doha Development Round. This major undertaking by all 149 WTO member countries will require substantial concessions by several countries, including the United States.

The WTO Ministerial Meeting in December 2005 in Hong Kong was supposed to wrap up the Doha Round. However, agricultural negotiators were unable to bridge the significant differences in agricultural proposals. Due to the importance of this sector for many developing countries' economies, agriculture plays a pivotal role in reaching an overall agreement. A successful conclusion of the Doha trade round without further opening of rich countries' markets seems unlikely.

Many developing countries' governments are concerned that the reduction in agricultural trade barriers has lagged behind that of most industrial goods, for which tariffs and other barriers have been reduced more forcefully over the last decades. Sugar, in particular, often faces high tariffs and other restrictions when exported to industrialized countries. Another controversial issue is the back-channeling of subsidized sugar into the world market, which causes prices on the world market to drop. This problem is at the heart of a challenge by Australia and Brazil in the WTO's dispute settlement system against the European Union's sugar regime, which has forced the EU to propose controversial changes to its sugar program to bring it into compliance with WTO rules.

Many developing countries' governments are concerned that the reduction in agricultural trade barriers has lagged behind that of most industrial goods, for which tariffs and other barriers have been reduced more forcefully over the last decades.

Other industry sectors, including several agricultural sectors hoping to expand their export opportunities, have been suffering because of delays in negotiations.

During the WTO Ministerial Meeting in December 2005, the U.S. sugar and cotton programs came under heavy criticism. The United States' reluctance to improve market access for sugar importers undermines its position in trade negotiations.

3.4. Farm Bill 2007

Upcoming trade negotiations are not the only issue looming over the sugar program. The forthcoming 2007 farm bill will bring a reevaluation of some agricultural support programs. Negotiations in Congress for the new farm legislation will start in 2006. With tighter public budgets this time around, the generous package provided to farmers in the 2002 farm bill might not be available. Also, support for the agricultural sector is not equally provided, as only about one third of all farms in the United States receive subsidies.[22] Thus, the current system of support for a few selected commodities might be increasingly difficult to justify. The consistent pressure on the federal budget is more likely to lead to cuts rather than expansion of existing expenditures to new crops.

IV. What Sugar Reform Needs to Address

A successful reform, short of outright elimination of the program, would need to address the critics' main concerns, as well as gather enough support from the program's proponents in the U.S. Congress.

Changes would need to address the need to allow more foreign sugar producers to compete in the U.S. market, which could reduce prices—which are today artificially high—for consumers and the sugar-using industries in the United States. In addition, reforms should address the economic incentives for overproduction in ecologically sensitive areas that the current support system provides.

A sustainable reform process has to provide political and legal certainty for sugar producers, refiners, and the sugar-using industries to allow long-term investment and business decisions to proceed. And any changes should be accompanied by a fixed timetable that is isolated from the election cycle and could not be changed on a political whim.

A sustainable reform process has to provide political and legal certainty for sugar producers, refiners, and the sugar-using industries to allow long-term investment and business decisions to proceed.

As a member of the World Trade Organization, the United States has committed itself to limit domestic agricultural support. Amendments to the sugar program would have to be compatible with American international obligations. The U.S. sugar program currently counts against the United States' so-called "amber box" commitments. The WTO categorizes agricultural domestic support programs into three general "boxes"—blue, amber, and green—based on their impacts on production levels and trade. The amber box represents support programs that increase production and cause the most distortion to international trade.[23]

During the last multilateral trade negotiations, the WTO's 1986-94 Uruguay Round, member countries agreed on cuts to the most trade-distorting policies and a similar result is expected from any future multilateral trade agreement. The current cap of $19 billion for the U.S. amber box could be reduced significantly. Even the U.S. WTO negotiating proposal from October 2005 called for a 60 percent reduction of the amber box support.[24]

Agriculture policies are influenced by international events, and the common international practice of subsidizing farmers makes agriculture a suitable target of international negotiations. Reform of the U.S. sugar regime could be accompanied by efforts to reduce international trade barriers in sugar markets, as well as removal of trade-distorting sugar subsidies worldwide. U.S. sugar producers have repeatedly emphasized that sugar policies should be discussed in the WTO setting rather than changed unilaterally.[25] But, as previous experience has shown, unilateral changes can bring meaningful reform.

V. Case Studies for Reform

5.1. New Zealand's Unilateral Removal of Agricultural Subsidies in the Mid-1980s

Most industrial countries protect their agricultural sectors with the help of tariffs and other trade barriers. Many countries also spend billions of dollars each year subsidizing their agricultural production.[26]

New Zealand, however, is an example of an industrialized country—likely the only one—that has voluntarily and unilaterally rid itself of most of its subsidies for farmers. It has also opened its markets to foreign competition by dismantling most import barriers, such as tariffs and import quotas.[27]

New Zealand is a relatively small country with just over 4.1 million people. Agriculture plays an important role in New Zealand's economy.[28] The sector represented 3.8 percent of the country's Gross Domestic Product (GDP) in 2004, and exports of agricultural, forestry, and horticultural products that year were valued at NZ$18.5 billion (US$13.2 billion), representing about 65 percent of New Zealand's total exports.[29]

In the early 1980s, New Zealand faced a severe financial crisis that included a high fiscal deficit, rising debt abroad, and the resulting devaluation of the New Zealand dollar. Those circumstances forced the country to reconsider many of its public policies, including the costs involved in supporting and protecting New Zealand's agricultural sector.

New Zealand's policy changes resulted in higher efficiency and an increase in exports.

While New Zealand has no significant domestic sugar production, some of the lessons from that country's sweeping reforms might be helpful in implementing sugar policy reform in the United States.

New Zealand opted for a "shock reform" that left farmers little time to adjust to the new policies. In 1984, New Zealand's government introduced a series of reforms that deregulated the agricultural sector, as well as several other industries. The government eliminated almost 30 subsidy programs in just one year. This put significant pressure on those producers that depended heavily on government payments for economic survival.[30]

Yet the transition process in New Zealand, while difficult for many farmers, did not lead to the collapse of the agricultural sector, as some had feared. In contrast, agricultural production has thrived over the two decades since the restructuring.

The policy changes had some positive effects for New Zealand's agricultural sector; according to the country's government, they resulted in higher efficiency and an increase in exports.[31]

While New Zealand's dramatic financial situation forced a radical reform course for the whole economy, much less is required for reforming the sugar sector in the United States. Yet policy makers can draw certain lessons from New Zealand's sugar reform experience.

New Zealand farmers, after a difficult transition, reoriented their production to reflect market demands rather than government preferences. Farmers now use resources in a more cost-efficient manner. As a result, agricultural overproduction has become less common.[32]

The benefits of New Zealand's reform also include environmental improvements and opportunities to serve niche markets.[33]

These economic opportunities developed after the removal of fiscal incentives for goods that did not meet market demands—a situation parallel to problems facing sugar producers in the United States, where production decisions are influenced as much by government policies as by market demands.

For example, the expansion of sugar cane production into the Florida Everglades, which has brought about significant ecological damage, has been encouraged by incentives for sugar cane growers. In addition, price supports have encouraged sugar beet production in areas where the costs of growing sugar beets might be uncompetitive without government intervention.

New Zealand's policies also shine light on whether long transition periods are helpful in softening the blow for those producers who cannot persevere in an open market.

A shortened transition can avoid the costs involved in continuing operations that lack long-term prospects. Instead, those resources could be used to speed up the exit of inefficient producers, by supporting reorientation and retraining, thereby allowing the competitive growers to benefit from the new market opportunities.

One option for the government to encourage producers to leave the market is a buyout of the recipients of subsidies and other support. Some benefits have been in place for so long that the beneficiaries include them in their long-term business and retirement planning.

5.2. Examination of U.S. Policy Changes as Possible Models for Sugar Reform

The following examples are of policy changes in the United States, where buyout programs were offered to peanut and tobacco producers. While these programs impact taxpayers directly, the costs represent either lump-sum or phased-out payments, which means that the payouts are temporary and transparent.

5.2.1. Peanut Quota Buyout Program in the United States

Before the 2002 farm bill, U.S. peanut farmers faced several restrictions if they wanted to grow and sell peanuts for the U.S. market. As part of another Great Depression agriculture program, peanut growers were required to hold production quotas if they wanted to sell peanuts for domestic consumption.

Quota holders were guaranteed a minimum price of $610 per ton of peanuts through a "quota-loan rate," while the loan rate for the additional peanuts was $132. Peanut producers without quotas could not undercut the minimum price, but were merely allowed to sell their peanuts for crushing—which achieves lower prices than for whole peanuts—and for exports. Meanwhile, the import of peanuts was restricted through tariff-rate quotas to avoid a drop in the domestic market price.[34]

With the approval of the 2002 Farm Act, the United States abolished the two-tiered price and domestic quota system for peanuts. All growers, independently of where they are located, can now produce peanuts for the domestic market and receive the same marketing loans.[35]

This arrangement also provided about 70,000 quota holders with a generous payout provided with U.S. taxpayers' money. Quota holders, who either used the quotas themselves for growing peanuts, but more commonly rented them out to other farmers, were offered payments in five annual installments of $220 per short ton during fiscal years 2002-06 or the option of taking the payment in a lump sum.[36]

In addition, after the 2002 Farm Act, peanut growers became eligible for other support programs offered to other commodity producers, such as counter-cyclical payments that, depending on market prices, can range from $0 to $104 per ton and fixed direct payments of $36 per ton.[37]

5.2.2. Tobacco Buyout Program

Since 2002, efforts had been underway to introduce a buyout program for tobacco farmers, similar to that for peanut quota holders. Finally, after a long debate over the form and costs of such a program, Congress, in October 2004, approved legislation—the Fair and Equitable Tobacco Reform—that included a buyout option for tobacco producers.[38]

The new law abolished the existing tobacco quota and price support program; however, it compensates quota holders and tobacco producers for the future reduction of their subsidies. Quota holders will receive $7 per pound based on the amount of quotas they owned in 2002. Tobacco producers will be paid $3 per pound for grown tobacco leaves based on their 2002 production. The U.S. Department of Agriculture estimates that the total payments will reach about $9.6 billion over the next 10 years. The money will go to about 437,000 quota owners and 57,000 producers.[39]

In contrast to the peanut quota buyout, which is financed by U.S. taxpayers, the tobacco buyout is funded by assessment fees on producers of tobacco products, as well as importers. They will be required to pay assessment fees over 10 years, according to their market shares. Furthermore, tobacco farmers will be excluded from further price supports and other subsidies. Tobacco farmers in return are now free to grow tobacco where they see fit.[40]

This new policy approach was in part triggered by the controversy over the existing tobacco policy. Public health concerns had led to restrictions on tobacco consumption in recent years. Meanwhile the subsidizing of tobacco production continued.[41]

Anyone attempting to quickly phase out the U.S. sugar program has to anticipate significant political opposition from sugar producers and their political allies in Congress.

Lawmakers from major tobacco-producing states initially opposed the cuts in support. However, the waning of public support for continuing the then-existing tobacco policy led to cooperation from farmers and local policy makers for reform of the program. In addition, market conditions were changing. The increased competition from abroad and the loss of overseas market shares made quota buyouts more lucrative compared to an uncertain economic future.[42]

Sugar producers might not face a similar erosion of public support as was the case for tobacco producers—but their political influence in states such as Florida has caused some public uneasiness. In addition, concerns about the environmental impact of sugar production in some parts of the country and the public association of sugar with broader nutritional worries have helped undermine the sugar producers' political influence.[43]

VI. Scenarios for Future Reform

Sugar policy reform in the U.S. could take one of three different paths: dismantling of the program over a short period, such as in the example of New Zealand; a buyout of producers' benefits and protection, as in the discussed buyout programs; or a long-term and slower draw-down of the support program.

6. 1. Quick Dismantling of the Current Sugar Program

Anyone attempting to quickly phase out the U.S. sugar program has to anticipate significant political opposition from sugar producers and their political allies in Congress. Such a scenario, however, could draw on New Zealand's experience of a "shock therapy" by removing support and protection over a short period of time.

The differences between political systems can influence how policy reforms are pursued in different countries. In a parliamentary system, such as in New Zealand, the leader of the governing party might possess more "persuasive" power over the members of its parliament than a U.S. president might have over members of Congress. In addition, a severe budget crisis and the devaluation of the currency can be more difficult to rectify for a small economy and might provoke more immediate policy changes. However, recent forecasts regarding the U.S. budget deficit and upcoming financial pressures relating to other issues could exert pressure on policy makers to reform domestic agricultural support programs.

The U.S. Congress might opt for a more "sellable" reform, considering that even a small expansion of sugar imports, such as in the CAFTA-DR trade agreement, has caused significant uproar by members from sugar beet and sugar cane growing states.

An interesting lesson from New Zealand might be that farmers in developed countries can be competitive on the world market even without subsidies and trade barrier protection. Despite protectionist claims that it is unfair for rich countries' farmers to have to compete with poorer and lower-wage countries, farmers in countries such as New Zealand have shown that they already experience many advantages over farmers from developing countries. Farmers in industrial countries have access to modern equipment that allows for mechanization of harvests and other processes. They also enjoy banking and loan systems that allow them to invest in such equipment, something often out of reach for farmers in many poor countries. Moreover, access to reliable transportation and infrastructure also give developed country farmers an advantage—while lack of the same often restricts developing country producers' access to markets.

The case of New Zealand might indicate whether long drawn-out transition periods are appropriate in today's business environment. If support is reduced to zero, for example, over 15 years instead of three years, does it help farmers? Producers and other businesses need the legal certainty to plan their investment in the future. Those producers who are willing and able to face the new competition will adjust swiftly rather than wait until the last days of the support regime. A low level of support at the end of the phase-out period would bring little comfort to anybody—producers in the U.S. or abroad.

A long-lasting phase-out adds to the political danger that producers will come to believe that they will have time to reverse the changes in the upcoming years.

In addition, a long-lasting phase-out adds to the political danger that producers will come to believe that they will have time to reverse the changes in the upcoming years. For example, the extended time frame of 15 years to phase out textile quotas in developed countries led some to believe that it would not happen at all. Sometimes this sentiment is fuelled by the lack of adjustment made by governments well in advance of such deadlines as the January 1, 2005 schedule for the removal of textile quotas. Some producers might lack preparedness for the change when it finally occurs, and some spend significant resources to lobby against the political change that would be better spent in adjusting to the market opening.

6.2. Buyout

Buyouts, as shown in the earlier examples of peanuts and tobacco quotas in the United States, can take different forms; and they can also be quite costly for taxpayers.

The main questions are: Who will be compensated in a buyout, and how will the buyout be financed? The changes to the tobacco and peanut programs benefited only U.S. producers; in other examples, third parties are compensated as well. In the case of the European Union's recently announced sugar reform proposals, several least-developed countries will be partly compensated for the loss of benefits after changes to the EU sugar regime.[44]

In the U.S., the number of sugar cane producers is relatively small and concentrated in a few states—Florida, Louisiana, Texas, and Hawaii. However, sugar beet growers are more numerous and spread among several mostly Midwestern states. Sugar cane and sugar beet producers represent roughly 50 percent of domestic sugar production.

For a successful buyout plan the support of significant parts of the sugar producing industry would be necessary. The question is: Would they ever agree to a buyout program, unless the whole program is threatened?

Whereas tobacco and peanut producers negotiated to include a buyout scenario during the last farm bill, sugar producers did not do so. However, agriculture and other sectors that could benefit from increased international trade negotiations might increase pressure on policy makers in their states. The looming budget deficit will play a major role in the upcoming debate over the new farm bill for 2007 and will certainly increase the pressure for reform.

If sugar beet and sugar cane growers do not believe that the overall sugar program is in danger of losing political support, it is unlikely that they will agree to any buyout, even if it is financially lucrative. On the other hand, taxpayers will only be willing to spend a limited amount of money on buyouts, especially since there are potentially more farming and other industry interests that might consider pushing for a similar "golden handshake."

The time is ripe for sugar reform in the United States; however, there is still significant political opposition to any changes to the support policy. Nevertheless, the pressure from consumers, the sugar-using industries, and environmental and taxpayer groups is growing.

6.3 Limited reform

Despite the lack of dramatic reform, several members of Congress have tried to introduce changes to the sugar program over the years. Many of those reform efforts were directed toward reducing the level of price supports to sugar producers—provided in the form of loan rates. During the debate on the 2002 farm bill, three amendments were introduced during the floor debates in the House and Senate to reduce the loan rates and to phase out the sugar program altogether. All three amendments were defeated by a large margin.[45]

Other reforms could include expanding import quotas, especially for poorer developing countries. In addition, a reduction of the over-the-quota tariff rate could make imports over the quota economically attractive for some countries, while adding money to the U.S. budget.

VII. Conclusions

The time is ripe for sugar reform in the United States; however, there is still significant political opposition to any changes to the support policy. Nevertheless, the pressure from consumers, the sugar-using industries, and environmental and taxpayer groups is growing. In addition, the obstacles that sugar policies in the United States and other industrial countries create for international trade negotiations are creating growing concern among other agricultural producers and other industry sectors. They do not want to see their potential benefits from opening up foreign markets to their products blocked by a few "special products" that receive special protection from foreign competition.

These examples of reform efforts in the area of agriculture represent different paths of change. They are not templates that are simply transferable into other areas of agricultural production; however, certain parallels can be drawn to possible sugar reform efforts.

The process will be more productive once a significant number of sugar producers regard reform as inevitable and start participating in revising the policy instead of blocking it.

To be successful, reform policy has to include certain characteristics. Reform efforts have been unsuccessful for decades because sugar producers could command enough political support for their side to block significant domestic changes. However, pressure for reform has arisen from criticism not only from within the United

States but also from outside. For example, progress in liberalizing trade in other areas puts pressure on agriculture to follow suit; bilateral trade agreements with its neighbors open up U.S. markets, thereby increasing demand to provide poorer countries with better chances to participate in the world economy.

History has shown that the sugar industry is slow in embracing changes. Yet the combination of both domestic and international pressure could finally start the process of sugar policy reform in the United States.

NOTES

[1] For an historic overview, *see* Roy A. Bollinger, "A History of Sugar Marketing through 1974," U.S. Department of Agriculture Economics, Statistics, and Cooperative Service, Agricultural Economic Report No. 382, March 1978, (http://www.ers.usda.gov/publications/aer382/).

[2] British Parliament, "The Sugar Act of 1764," (http://www.founding.com/library/lbody.cfm?id=85&parent=17)

[3] Bollinger (1978), p. 5-6.

[4] Ibid., p. 34.

[5] Ron Lord, "Sugar: Background for 1995 Farm Legislation," Commercial Agriculture Division, Economic Research Service, U.S. Department Agriculture, Agricultural Economic Report No. 711, April 1995, p. 24.

[6] Donald Mitchell, "Sugar Policy: Opportunity of Change," World Bank, Trade Note 14, March 1, 2004, p. 1, (http://siteresources.worldbank.org/INTRANETTRADE/Resources/Pubs/TradeNote14.pdf).

[7] Remy Jurenas, "Sugar Policy Issues," Resources, Science, and Industry Division, Congressional Research Service, updated March 2005, p. 1.

[8] USDA/Economic Research Service: Briefing Room, sugar and sweeteners: policy, (http://www.ers.usda.gov/Briefing/Sugar/policy.htm).

[9] The U.S. over quota tariff started at 17.62 cents a pound in 1995 and was reduced by 0.46 (0.452) cent each year down to 15.36 cents a pound since 2000.

[10] USDA/Economic Research Service: Briefing Room, sugar and sweeteners: policy, (http://www.ers.usda.gov/Briefing/Sugar/policy.htm).

[11] Stephen Haley and Nydia Suarez, USDA Economic Research Service, "USDA Agricultural Outlook," September 2000, (www.ers.usda.gov/publications/agoutlook/sep2000/ao274e.pdf).

[12] Remy Jurenas, "Sugar Policy Issues," Resources, Science, and Industry Division, Congressional Research Service, April 13, 2001, (http://www.ncseonline.org/nle/crsreports/agriculture/ag-27.cfm?&CFID=18139154&CFTOKEN=18093683#_1_10).

[13] Stephen Haley and Nydia Suarez, USDA Economic Research Service "Sugar and Sweeteners Outlook," May 31, 2002, (http://usda.mannlib.cornell.edu/reports/erssor/specialty/sss-bb/2002/sss234r.pdf).

[14] USDA Economic Research Service, Briefing Room, farm and commodity policy: 1996-2001 program provisions, (http://www.ers.usda.gov/Briefing/FarmPolicy/1996sugar.htm).

[15] Paul C. Westcott, C. Edwin Young, and J. Michael Price, "The 2002 Farm Act: Provisions and Implications for Commodity Markets," Economic Research Service/USDA, AIB-778, November 2002, p. 8, (http://www.ers.usda.gov/publications/aib778/).

[16] For examples, *see* statements by National Farmers Union and the American Farm Bureau on CAFTA-DR, (http://www.nfu.org/newsroom_news_release.cfm?id=1338), (http://www.fb.org/news/nr/nr2004/nr0528.html).

[17] USDA AmberWaves February 2006 Indicators (http://www.ers.usda.gov/AmberWaves/February06/Indicators/).

[18] Office of the U.S. Trade Representative, "Sugar: A Spoonful A Week," CAFTA Policy Brief, February 2005, (http://www.ustr.gov/assets/Trade_Agreements/Bilateral/CAFTA/Briefing_Book/asset_upload_file 923_7210.pdf).

[19] American Sugar Cane League, News Release about CAFTA July 29, 2005, (http://www.amscl.org/news/Default.htm)

[20] The United States and Peru completed negotiations on a free trade agreement on December 7, 2005, *see*, press release Office of the U.S. Trade Representative, "United States and Peru Conclude Free Trade Agreement," December 7, 2005, (http://www.ustr.gov/assets/Document_Library/Press_Releases/2005/ December/asset_upload_file744_8518.pdf).

[21] USDA Foreign Agricultural Service, "NAFTA Agriculture Fact Sheet: Sugar," (http://www.fas.usda.gov/itp/Policy/NAFTA/sugar.html).

[22] *See,* Environmental Working Group, (http://www.ewg.org:16080/farm/index.php).

[23] For detailed explanation *see* the WTO website, (http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm3_e.htm).

[24] Office of the USTR Doha Development Agenda Policy Brief, "Facts on Doha Round," October 2005, (http://www.ustr.gov/assets/Document_Library/Fact_Sheets/2005/asset_upload_file919_8128.pdf)

[25] For example, *see*, Submission of U.S. Sugar Industry to U.S. International Trade Commission Hearing: Investigation Nos. TA 131-27 and TA-2104-9; TA-131-28 and TA-2104-10 Proposed Free Trade Agreement Negotiations between the United States and Panama; and between the United States and the Andean Countries: Advice Concerning Probable Economic Effect Washington, D.C. January 23, 2004.

[26] Organization for Economic Co-operation and Development (OECD), Highlights: "Agricultural Policies in OECD Countries: Monitoring and Evaluation 2005," June 2005, (http://www.oecd.org/dataoecd/33/27/ 35016763.pdf).

[27] Ibid., p. 61.

[28] Statistics New Zealand (http://www.stats.govt.nz/economy/default.htm).

[29] Ministry of Agriculture and Forestry of New Zealand: Key Facts, (http://www.maf.govt.nz/mafnet/rural-nz/agriculture-forestry-horticulture-in-brief/2005/key-facts-01.htm).

[30] Rhodes, T., Willis, B.H., Smith W., McCann J., "Farm Adjustment and Restructuring in the North Island Hill Country," MAF Technical Paper No: 2003/2, January 2003, (http://www.maf.govt.nz/mafnet/rural-nz/profitability-and-economics/farm-adjustment-and-restructuring/farm-adjustment05.htm).

[31] Ibid.

[32] Allan Rae, Chris Nixon and Ralph Lattimore, "Adjustment to agricultural policy reform – issues and lessons from the New Zealand experience," The New Zealand Trade Consortium and New Zealand Institute of Economic Research, NZ Trade Consortium

working paper no 35, February 2004, p.8 (http://www.nzier.org.nz/SITE_Default/SITE_Publications/x-files/12060.pdf).

[33] Ibid, p.22.

[34]E. Dohlman,, E. Young, L. Hoffman, W. McBride, "U.S. Peanut Sector Adapts to Major Policy Changes," USDA Economic Research Service, AmberWaves, November 2004, (http://www.ers.usda.gov/AmberWaves/ november04/features/peanutsector.htm).

[35] Ibid.

[36] Erik Dohlman and Janet Livezey, "Peanut Backgrounder," USDA Economic Research Service
Electronic Outlook Report OCS-05i-01, October 2005, p. 2-4.

[37] Counter-cyclical payments are available for some producers whenever the commodity price is less than a target price. Payments are called counter-cyclical since they vary inversely with market prices. Direct payment: Fixed payments are provided for eligible producers of wheat, corn, barley, grain sorghum, oats, upland cotton, rice, soybeans, other oilseeds, and peanuts. (http://www.ers.usda.gov/features/farmbill/2002glossary.htm#c)

[38] Thomas C. Jr. Capehart, "Long-Lived Tobacco Program to End," AmberWaves February 2005, (http://www.ers.usda.gov/AmberWaves/February05/Findings/LongLivedTobacco.htm).

[39] David Orden, "Key Issues for the Next Farm Bill: Is a Farm Program Buyout Possible," Agricultural Outlook Forum 2005, presented February 24, 2005, (http://www.usda.gov/oce/forum/speeches/Orden.pdf).

[40] Orden (2005).

[41] Capehart (2005).

[42] Ibid.

[43] For background information, *see*, Ellen S. Miller, "The Politics of Sugar," Center for Responsive Politics, May 1995 (http://www.opensecrets.org/pubs/cashingin_sugar/sugar00.html) and Center for Responsive, "Sugar: Background," (http://www.opensecrets.org/industries/background.asp? Ind=A1200&cycle=2004).

[44] The reform proposal by the European Union, recommends 40 million euros to compensate those low-income countries that have preferential access to the high-priced EU market. See for more details: EU website (http://www.europa.eu.int/comm/agriculture/capreform/sugar/index_en.htm)

[45] Jurenas (2005) p. 7-8.

About the Authors

Barbara Rippel was a consultant to the Sugar Reform Alliance; Frances B. Smith is Adjunct Fellow, Competitive Enterprise Institute, and coordinator of the Sugar Reform Alliance; Ivan Osorio is Editorial Director, Competitive Enterprise Institute. The Sugar Reform Alliance is a working group of non-profit organizations that promotes the need for reform of the U.S. sugar program to benefit consumers, taxpayers, workers, and the environment.

$8.00

The Competitive Enterprise Institute is a non-profit public policy organization dedicated to the principles of free enterprise and limited government. We believe that consumers are best helped not by government regulation but by being allowed to make their own choices in a free marketplace. Since its founding in 1984, CEI has grown into an influential Washington institution.

We are nationally recognized as a leading voice on a broad range of regulatory issues ranging from environmental laws to antitrust policy to regulatory risk. CEI is not a traditional "think tank." We frequently produce groundbreaking research on regulatory issues, but our work does not stop there. It is not enough to simply identify and articulate solutions to public policy problems; it is also necessary to defend and promote those solutions. For that reason, we are actively engaged in many phases of the public policy debate.

We reach out to the public and the media to ensure that our ideas are heard, work with policymakers to ensure that they are implemented and, when necessary, take our arguments to court to ensure the law is upheld. This "full service approach" to public policy makes us an effective and powerful force for economic freedom.

CEI
Competitive
Enterprise
Institute

1001 Connecticut Avenue, NW
Suite 1250
Washington, DC 20036
202-331-1010
Fax 202-331-0640
www.cei.org