

SWEETENER USERS ASSOCIATION

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Report Warns That New Farm Bill Invites Global Trade Rule Challenges *Proposed Sugar Program Provisions Increase Risk of WTO Challenge*

Washington, D.C. – October 10, 2007 – In a report prepared for the Sweetener Users Association (SUA), international trade consulting firm O’Mara & Associates today warned that increased sugar price supports and new import restrictions included in the 2007 farm bill would violate World Trade Organization (WTO) rules and lead to legal challenges from countries that export sugar to the United States, as well as possible retaliation against exports of U.S. farm and ranch commodities.

“By reducing access for foreign sugar to the US market, the farm bill passed by the House would put the US sugar program at increased risk for challenges at the WTO,” according to Charles J. (Joe) O’Mara, president of O’Mara & Associates and chief US agriculture negotiator during the Uruguay Round and NAFTA trade talks. “When it takes up the new farm bill, the Senate should consider carefully whether giving additional subsidies to sugar producers and further restricting sugar imports are worth the increased risk of costly WTO challenges and possible retaliation against other US commodities in the global market,” O’Mara added.

According to the SUA, the increased price supports and additional import restrictions included in the farm bill passed by the House in August are incompatible with the nation’s foreign trade obligations and the realities of the 21st century global market place that include unrestricted access for Mexico under the NAFTA treaty beginning in January 2008.

SUA represents confectioners, bakers, cereal manufacturers, beverage makers and dairy food companies that use sugar, as well as trade associations for these industries. SUA members support a healthy domestic sugar-producing and sugar-processing industry that can deliver an ample supply to refiners, industrial users, and consumers, but SUA believes sugar policy should support producer incomes without distorting the market.

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**Proposed Changes to the U.S. Sugar Program and
International Trade Obligations**

Report to the Sweetener Users Association

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The development of a new farm bill presents a unique opportunity to provide income support for US producers which is sustainable and predictable. This opportunity comes at a time when the chances of successful challenges to U.S. farm programs in the World Trade Organization are increasing and are broader in scope. This trend began with Brazil's challenge of US Cotton and Export Credit Programs. Although the focus of that case was cotton and the use of export credits, the findings are expected to affect many other commodities. The latest Brazil challenge cites many US agriculture programs. Canada has already requested a Panel and Australia is considering their own cases or possibly joining Brazil.

For US sugar producers, the new farm bill should provide income support which is sustainable and predictable while also taking into account international obligations. There are ways to provide income support while also reducing the risk of WTO challenges. However, as proposed in the farm bill passed by the House of Representatives (H.R. 2419), prospective changes to the sugar program present the following potential conflicts:

1. Establishing a statutory date before which the Secretary can take action to increase imports to supply the domestic market; making mandatory the application of orderly shipping patterns; and guaranteeing 85 percent of domestic consumption to US-produced sugar, places the United States at risk of violating several provisions of the General Agreement on Tariffs and Trade (GATT) 1994, including:
 - a. Article III: National Treatment on Internal Taxation and Regulation;
 - b. Article XI: General Elimination of Quantitative Restrictions;
 - c. Article XIII: Non-Discriminatory Administration of Quantitative Restrictions; and
 - d. Article XXIII: Nullification or Impairment
2. The United States has not notified, to the WTO, the Aggregate Measurement of Support (Amber Box) since 2001¹. Therefore it is unclear how domestic marketing allotments for sugar will be treated in future notifications. However, under the Uruguay Round Agreement on Agriculture rules, domestic marketing allotments appear to be product specific support that does not qualify for exemption from reduction commitments.
3. The potential cost of the "Feedstock Flexibility Program" in H.R. 2419 is not clear, and thus government outlays in the Aggregate Measurement of Support

¹ The first such notification was made by the U.S. government for the years 2002-2005 just after this paper was completed. Detailed breakdown of the AMS is not yet publicly available.

(AMS) to fund this program are unpredictable. However, the program is clearly related to sugar prices and so would be included in the AMS.

Taken as a whole, the combination of new and more rigorous restrictions on imports, coupled with setting domestic marketing allotments at 85 percent of domestic consumption appears to reduce access for imported sugar. Thus, the benefits provided to WTO Members with rights to export sugar to the United States will be reduced, which increases the risk of a WTO challenge.

In addition, increasing trade-distorting domestic support for sugar, at a time when the US is facing new potential challenges that will attempt to prove the US has breached its annual AMS commitment of \$19.1 billion, will not only create vulnerabilities for sugar, but also reduce the ability for Congress to provide amber box support to many other commodities.

Sugar Program

The United States government employs several tools to operate the US sugar program at no net cost to taxpayers as required by the 2002 Farm Security and Rural Investment (FSRI) Act, including: a non-recourse loan program; a tariff rate quota (TRQ); and domestic marketing allotments. The loan program guarantees a minimum price for raw cane sugar at 18 cents per pound and refined beet sugar at 22.9 cents per pound. Loans are made available to processors, who thereby incur certain minimum payment obligations to producers that deliver sugarbeets or sugarcane to them.

As established at the conclusion of the Uruguay Round Agreement on Agriculture (URAA), the US maintains tariff rate quotas (TRQs) for both raw cane and refined sugar. The US is committed to import annually a minimum 1,117,195 metric tons of raw cane sugar and 22,000 metric tons of refined sugar. Prior to the beginning of every marketing year (October-September), the TRQ for raw cane sugar is allocated by the US Trade Representative among the 40 traditional supplying countries. The refined TRQ has a portion reserved for Canada and Mexico and the remainder is on a “first come first served” basis. Most sugar imports are managed through Certificates of Quota Eligibility, issued by the Secretary of Agriculture.

The United States notifies the WTO of domestic sugar support in the Aggregate Measurement of Support (AMS) (Amber Box). The sugar support is valued at approximately \$1 billion. The US followed the methodology as outlined in Annex III paragraph 8 of the URAA to determine the annual product specific support for sugar².

Marketing allotments were originally authorized by the Agriculture Adjustment Act of 1938. Since, allotments have been authorized in various farm bills, including in the Food, Agriculture, Conservation and Trade Act of 1990 and the current Farm Security and Rural Investment Act of 2002. Allotments were not authorized in the Food Security Act of 1985 or the 1996 Federal Agriculture Improvement and Reform (FAIR) Act of 1996.

The law requires the Secretary of Agriculture, no later than August 1 before the beginning of each marketing year, to estimate the supply and demand for US sugar and establish the Overall Allotment Quantity (OAQ) by deducting from the sum of domestic sugar consumption and reasonable carryover stocks: (A) 1,532,000 short tons raw value (STRV); and (B) carry in stocks of sugar, including in Commodity Credit Corporation (CCC) inventory. The Secretary of Agriculture is authorized to re-estimate the OAQ quarterly and, if needed, increase the TRQ, provided adjustments do not result in the forfeiture of sugar to the CCC.

² Annex III paragraph 8 Uruguay Round Agreement on Agriculture: Market price support shall be calculated using the gap between the fixed external reference price and the applied administered price multiplied by the quantity of production eligible to receive the applied administered price. Budgetary payments made to maintain this gap, such as buying in or storage costs, shall not be included in the AMS.

The FSRI Act of 2002 established 1,532,000 STRV as a target volume of sugar that could be imported in any marketing year while maintaining domestic marketing allotments. Should the Secretary of Agriculture estimate that imports will exceed 1,532,000 STRV, marketing allotments are supposed to be suspended, if the increase in imports would also lead to a reduction in the OAQ³. This has not, in fact, occurred, primarily because certain imports do not count toward the 1,532,000 STRV “trigger.”

Proposed Changes to the Sugar Program

As passed by the House of Representatives in H.R. 2419, the sugar program could change significantly. Proposed changes including the following:

- a) Increasing price supports for both raw cane sugar and refined beet sugar to 18.5 cents per pound for raw and 23.5 cents per pound for refined beet sugar⁴;
- b) Mandating CCC to purchase cane or beet sugar for resale to bioenergy plants as a feedstock;
- c) Statutorily setting Flexible Marketing Allotments for sugar at a minimum of 85 percent of the estimated quantity of sugar for domestic consumption; and
- d) Significantly altering the administration of the TRQ, including:
 - Establishing April 1 as a statutory date for the Secretary to take action to increase supply – previously there was no such date; and
 - Establishing orderly shipping patterns for major suppliers of sugar, defining a very large major supplier and large major supplier and limiting the ability for quota holders to fill their allocation by dividing allocations by quarters and semi-annually.

Vulnerabilities of US Sugar Program

These proposed changes in the House bill have raised concerns about compliance with the URAA and the vulnerability of the new provisions to challenge in the future. (The White House mentioned this issue among others in its formal Statement of Administration Policy on H.R. 2419.)

With the expiration of the of Article 13 of the URAA, commonly known as the Peace Clause, the potential for a challenge in the WTO Dispute Settlement Body (DSB) increases significantly. The Peace Clause provided an exemption from action under the Uruguay Round Subsidies and Countervailing Measures (SCM) Agreement during the implementation period of the URAA (1996-2002), provided that WTO Members complied with the URAA. Now that the Peace Clause is no longer in effect, any WTO Member can challenge any domestic support program for

³ Section 359(h) of the Farm Security and Rural Investment Act of 2002.

⁴ Section 156 (a) and (b) of H.R. 2419

agriculture under the SCM Agreement. Therefore, generally US agricultural policies, as well as other WTO Members' agriculture programs, are much more vulnerable to actions under the SCM Agreement.

In 2002 Brazil launched two significant WTO challenges. Brazil successfully applied the SCM Agreement to US agriculture subsidies. Against the European Union (EU), Brazil made claims that the EU used export subsidies to sell sugar on the world market in excess of their URAA commitments. This case resulted in the EU reforming its sugar program, including the elimination of export subsidies for sugar, therefore moving the EU from being a net exporter to a net importer of sugar.

Recently Canada has requested a Dispute Settlement Panel be formed, and Brazil has requested consultations, the first step in launching another challenge against US domestic support programs. In this case, Brazil and Canada will use a finding from the US-Cotton case as their main claim that the US has not complied with its domestic support commitments, and therefore has provided trade-distorting domestic subsidies in excess of its bound AMS commitment of \$19.1 billion.

The key to this case is the finding by the Dispute Settlement Panel (Panel) and Appellate Body (AB) in the US-Cotton case that US Production Flexibility Contract (PFC) payments as authorized in the 1996 FAIR Act and Direct Payments in the 2002 FSRI Act do not conform with the criteria in Annex II (Green Box), and are therefore not exempt from US reduction commitments in the AMS because the US law restricts the planting of fruits, vegetables and wild rice on program acres eligible for these payments. If the process proceeds to a Panel, and Brazil and Canada successfully argue that PFC and Direct Payments should be included in the AMS, the US would end up with a significant increase in its AMS. This has potential for the US to breach its non-product specific *de minimis*⁵ exemption, which (depending on the amount notified for counter-cyclical payments and crop insurance) could add well in excess of the cost of direct payments to the AMS calculation. Brazil claims that by including these payments in the AMS, the US would have exceeded its AMS commitments from 1999-2002, 2004 and 2005. Brazil included many agriculture programs in their consultations, including domestic sugar marketing allotments.

Regardless of the Peace Clause and the application of the SCM Agreement, WTO Members are obligated to comply with the rules of the URAA and the General Agreement on Tariffs and Trade (GATT) 1994. With respect to sugar, provisions in both the current law and proposed changes in H.R. 2419 raise several fundamental concerns regarding US compliance with GATT 1994 and the URAA. These concerns involve how the TRQ is administered and how marketing allotments and the Flexible Feedstock for Bioenergy Program should be treated with respect to US reduction commitments for domestic support. The following is an assessment of areas where US law and WTO obligations intersect and are likely incompatible.

⁵ URAA Article 6 paragraph 4(ii): non-product specific domestic support which would otherwise be required to be included in a Member's calculation of its Current AMS where such support does not exceed 5 percent of the value of that Member's total agriculture production.

It is worth noting, before proceeding with the analysis, that both Brazil and Australia, major sugar exporters to the United States, have proven to be quite litigious in the WTO. Australia joined as a third party in both the US-Cotton Case and the EU-Sugar Case. If either Brazil or Australia considers the sugar provisions of H.R. 2419 to violate WTO rules, one or more dispute settlement cases should be anticipated.

TRQ Administration

Article XI of the GATT 1994 (“General Elimination of Quantitative Restrictions”) generally prohibits the use of import restrictions, other than duties, taxes or other charges. Agriculture, however, was provided an exemption, with which Members are allowed to maintain quantitative restrictions (such as TRQs) in order to operate domestic agriculture programs, provided that a quantitative restriction “...not be such as will reduce the total of imports relative to the total of domestic production.”⁶

Prior to the URAA, many GATT Members maintained quotas to restrict access to their domestic markets, including the United States. However, Australia successfully challenged US sugar quotas in 1989. This challenge and the result of Uruguay Round transitioned the US Sugar Quota into a TRQ.

To conform to both the ruling from the Australian case and the Uruguay Round the United States established 1975-1981 as the base period for determining the volume of imports to be allowed through the TRQ. These years were used because the US did not maintain any quotas on imports of sugar during this period. Under WTO rules, a quantitative restriction should provide Members with “as closely possible the shares which the various contracting parties might be expected to maintain in the absence of such restrictions.”⁷

While the TRQ makes available the same volume of access as during the 1975-81 period, the US sugar market has changed significantly since the Uruguay Round. Subsequently, the United States has provided additional access to Mexico through the North American Free Trade Agreement (NAFTA) and to the six countries⁸ of the Dominican Republic-Central American Free Trade Agreement (DR-CAFTA). Moreover, sugar trade with Mexico will be unrestricted as of January 2008, when the NAFTA comes fully into force. Pending FTAs with Peru, Panama and Colombia will also provide for modest additional sugar imports if these pacts are approved by Congress.

Therefore, it is unclear how the United States will be able to meet its international commitments while maintaining the US sugar program as structured in the 2002 FSRI Act and the proposed changes in H.R. 2419. If the countries that are eligible for the TRQ, such as Brazil and Australia, believe their access to the US market as agreed in the Uruguay Round is reduced by the US sugar program and increased

⁶ GATT 1994 Article XI paragraph 2

⁷ Article XIII of GATT 1994

⁸ Dominican Republic, Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua

imports under NAFTA or DR-CAFTA, those WTO Members have the right to seek adjustments to ensure TRQ benefits are maintained as provided in Article XXIII of the GATT 1994, “Nullification and Impairment.”⁹

Article XXIII goes on to state that if no resolution can be reached, then, in this case, the quota holders can take action in the WTO dispute Settlement Body.

There are various aspects of the proposed changes to TRQ administration in H.R. 2419 that could reduce access for quota holders under the TRQ. Should this happen, quota holders will have the right to pursue action under the WTO Dispute Settlement Body.

Potential Inconsistencies of TRQ Administration

H.R. 2419 includes new statutory provisions that will make the operation of the US TRQ more rigid and thus further restrict the sugar supply in the US market. In addition, these provisions reduce significantly the Secretary of Agriculture’s discretion in establishing and operating the TRQ.

The provisions of H.R. 2419 which are the cause of greatest concern include the following:

- a) Establishing April 1 of the fiscal year as the earliest date on which the Secretary can take action to increase supply into the US market, barring an “emergency shortage,” and
- b) The establishment of Orderly Shipping Patterns.

It is important to view these programs as a whole and in combination with other provisions of H.R. 2419, specifically those setting domestic marketing allotments at a minimum of 85 percent of domestic consumption. These proposed changes, viewed in the context of US obligations in the WTO, potentially place the US industry at increased risk of a WTO challenge, particularly if the affect is to reduce the proportion of imports to domestic consumption¹⁰. These provisions appear to be structured so to provide less access to imported sugar and provide US produced sugar far more favorable treatment than accorded to other WTO members. Thus, domestic producers are guaranteed a greater share of the US market than they were before (there is no minimum level for domestic allotments under current law). Meanwhile, foreign sugar above the WTO minimum is effectively barred by law from the US market for one-half of the entire fiscal year except in case of an emergency – a bar which does not exist in statute today. Simultaneously, foreign sugar even in the minimum amounts is rationed quarter-by-quarter – again, a legal

⁹ Nullification and Impairment “If any WTO Member should consider that any benefit accruing to it directly or indirectly under this Agreement (GATT 1994) is being impeded as the result of: (a) the failure of another WTO Member to carry out its obligations under this Agreement; or (b)The application of another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement; or (c) the existence of any other situation; The WTO Member may with a view to satisfactory adjustment of the matter make written representations or proposals to the other Member or Members to which it considers to be concerned.”

¹⁰ Article XI of the GATT 1994 “General Elimination of Quantitative Restrictions”

barrier that is not part of any statute today, although it has at times been enforced by regulation.

If in fact foreign sugar does have less access and domestic producers receive more favorable treatment, WTO Members can pursue challenges based on: (1) Nullification and Impairment of a quota holder's benefit under the TRQ¹¹; (2) violation of Non-discriminatory Administration of Quantitative Restrictions¹²; (3) violation of General Elimination of Quantitative Restrictions¹³; and (4) violation of National Treatment¹⁴ of GATT 1994.

Establishing April 1 of the marketing year as the first date the Secretary of Agriculture can take action to increase supply into the US market, barring an "emergency shortage,¹⁵" means that US processors of sugarcane and sugar beets are provided preferential access to the domestic market over imported sugar for the period between October and April. Without a declaration of an "emergency shortage," and if supply is nevertheless tight, the April 1 date will bar the Secretary of Agriculture from increasing the TRQ. This will allow US processors to sell the newly processed sugar and any carry over stocks from the previous year with only minimal competition from quota holders during the first half of the marketing year.

The benefit provided by the April 1 date is augmented by the addition of section 359K(c) of H.R. 2419 that categorizes many offshore suppliers as either "Very Large Major" or "Large Major". "Orderly Shipping Patterns" will dictate, in statute, the amount of sugar that can enter on a quarterly or semi-annual basis, depending on the size of the supplier's quota. For example, if the larger quota holders, e.g., the Dominican Republic and Brazil, have sugar to export, orderly shipping patterns will determine how much of their quota can be filled. These countries would be categorized as "Very Large Major" and so would only be eligible to ship a quarter of their quota allocation in the first quarter of the marketing year, and then in the second quarter would be eligible to ship another quarter of their quota, and so on. This ensures that the largest quota holders will not derive the full benefit of their quota right based on market fundamentals during the year, but only when the US law permits.

In the past, the Secretary of Agriculture established specific shipping patterns for periods of time, but this practice has never been permanent or mandatory. By transitioning this episodic practice into a permanent program, Congress removes the Secretary's discretion to allow a quota holder to exceed its quarterly or semi-annual allocation.

¹¹ Article XXIII of GATT 1994, Nullification and Impairment

¹² Article XIII of GATT 1994

¹³ Article XI of GATT 1994

¹⁴ Article III of GATT 1994, National Treatment

¹⁵Section 359k(b)(1)a: Emergency shortage in the United States market that is caused by war, floods, hurricanes, or other natural disaster, or other similar event...

The April 1 date and “Orderly Shipping Patters for Major Suppliers” essentially guarantee that domestically produced sugar is provided more favorable treatment by ensuring that the largest quota holders are not eligible to export more than their quarterly or semi-annual allocation provides. Domestically produced sugar may be marketed at any time during the year, but imported sugar – specifically, sugar imported in fulfillment of a right clearly enjoyed by foreign suppliers to the U.S. market – may *not* be marketed at any time during the year, but only at certain times that may or may not correspond to the times when the quota-holder would derive the best price and value for its sugar.

These provisions on their own, and acting in combination, threaten to violate quota holders’ rights under the TRQ, placing the US industry at increased risk for a WTO challenge under Article XXIII, Nullification and Impairment, and at increased risk of violating Article III of GATT 1994 “National Treatment on Internal Taxation and Regulation.” Specifically, paragraph 4¹⁶ states that WTO Members cannot provide preferential treatment to a domestic industry over another WTO Member’s similar industry.

In addition, if establishing April 1 as the first date the Secretary of Agriculture can take action to increase supply, barring an emergency shortage, and mandating “Orderly Shipping Patters,” should result in reduced access for the largest suppliers during the first half of the marketing year, the United States could also violate US obligations under Article XIII of GATT 1994. “Non-discriminatory Administration of Quantitative Restrictions,” specifically paragraph 2(d)¹⁷, by preventing Members with rights to export raw cane sugar to the United States under the TRQ from filling the allocations provided to them on a fiscal year basis. Restricting access for particular quota holders throughout the marketing year may result in some quota holders not filling their quota and never realizing the full benefit of that quota.

These changes and the potential for increased unrestricted access for sugar from Mexico present a major challenge to the United States. On one hand, the United States has an obligation to provide access to Mexico with full implementation of the NAFTA. However, this does not negate the obligations the United States has with respect to the WTO. Without a change in the US program, it should be expected that some party -- either Mexico or WTO quota holders -- will be negatively affected. H.R. 2419, by its terms, makes it appear that the United States has chosen to reduce access for quota holders. That will, without question, invite increased scrutiny of the US sugar program and increase the chances that quota holders will challenge the program in the WTO.

¹⁶ “The products of the territory of another WTO Member imported into the territory of any other contracting party shall be accorded treatment no less favorable than that accorded to the like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.”

¹⁷ ...No conditions of formalities shall be imposed which would prevent any contracting party from utilizing fully the share of any such total quantity or value which has been allotted to it...

The United States must maintain the TRQ so that access is provided to quota holders, in a way that does not diminish their benefits and does not provide for more favorable treatment of the domestic industry. Mandating April 1 as the first date the Secretary can take action to increase supply during the marketing year and codifying orderly shipping patterns, in combination with guaranteeing that US processors will have 85 percent of domestic human consumption, appears to be a direct contradiction of US obligations.

Marketing Allotments

Marketing allotments are a tool used by the US government to restrict the amount of sugar that can be sold into the domestic market place during the marketing year and are another policy instrument used to operate the sugar program at no net cost to the taxpayer. The FSRI Act of 2002 authorized the Secretary to establish marketing allotments based on annual supply and demand estimates.

Marketing allotments were not authorized in the 1985 Food Security Act. The URAA established 1986-88 – during the lifetime of that Act -- as the base period from which WTO Members would calculate their annual reduction commitments for the purposes of the Aggregate Measurement of Support (AMS)¹⁸. At the time, the only form of income support available to the sugar industry was the loan program.

Non-recourse loan rates for US refined sugar of 22.9 cents per pound, and for raw sugar of 18 cents per pound, protect producers from market prices falling below the statutory loan rates. This program is the basis for determining the support provided to US sugar. Following the methodology outlined in the URAA, Annex III paragraph 8, the US calculated total sugar support at approximately \$1 billion annually.

While the loan program guarantees the industry receives a minimum price, it does not help processors maximize market returns, as accomplished with marketing allotments. Regardless of the market price for sugar, marketing allotments, as authorized in the FSRI Act of 2002, guarantee a portion of the US market for domestically produced sugar and at a minimum price, thereby establishing a minimum annual income depending on the amount of sugar the Secretary of Agriculture makes eligible to be sold each year. Further, the US Government is the buyer of last resort, as the law requires that the CCC accept bids to obtain raw cane sugar and refined sugar, in return for a reduction in production.

The proposed change to marketing allotments in H.R. 2419 goes a step further to guarantee that processors can depend on marketing a minimum of 85 percent of

¹⁸URAA Article 6 paragraph 1: “The domestic support reduction commitments of each Member contained in Part IV of its Schedule shall apply to all of its domestic support measures in favor of agricultural producers, with the exception of domestic support measures which are not subject to reduction in terms of the criteria set out in Article 6 and in Annex 2 (Green Box) to this Agreement. The commitments are expressed in terms of Total Aggregate Measurement of Support (AMS) and ‘Annual and Final Bound Commitment Levels.’”

domestic consumption. That is, the statute would guarantee that 85 percent of the domestic consumption of sugar must come from domestically produced sugar.

Absent marketing allotments, the US sugar industry is only guaranteed income based on price and eligible production, the basis for the income support notified to the WTO. With marketing allotments, the stated purpose is to operate the sugar program at no net cost to taxpayers, by avoiding forfeitures of sugar. Therefore, in practice marketing allotments have not only maintained prices at the statutory loan rates, they have increased prices in excess of the loan rates – precisely what they must do by definition, if they are to avoid forfeitures. Thus there is a guaranteed increase in income above the support price established by the US government.

The United States has not reported its AMS to the WTO since 2001.¹⁹ Therefore it is not possible to know if marketing allotments will be notified as additional support in the product-specific AMS for sugar. However, if the AMS is not increased, WTO Members may question why the US has not notified marketing allotments as trade-distorting domestic support, and further, how marketing allotments would be exempt from reduction commitments, as they do not appear to be consistent with any URAA exemption.

According to analysis of the impact of marketing allotments by USDA's Economic Research Service:

“Flexible marketing allotments are likely to provide more effective price support throughout the marketing year. When allotments are in effect, processors who have expanded marketings in excess of the rate of growth in domestic sugar demand will have to postpone sale of some sugar and either store it at their own expense or sell it for uses other than domestic food use. Without allotments, price support comes from forfeiting sugar under CCC loan in the fourth quarter (July-September) of the fiscal year. The forfeiture withdraws sugar from the market, thereby reducing excess sugar supply and helping to support the market price of sugar.²⁰”

This analysis suggests that without marketing allotments, price support provided by the loan program does not as effectively maintain market prices in excess of the loan rates. (The analysis would seem to be confirmed by the experience of fiscal year 2000, when some 1 million tons of sugar were forfeited to the government, an event that played a role in convincing the industry to support marketing allotments two years later.)

Further, another report by the Economic Research Service separated the income support provided by the marketing allotments from the benefits of the non-recourse loan program, stating:

“The support is embedded in the price that purchasers pay for sugar. By controlling the market supply of sugar through domestic marketing allotments and tariff-rate import quotas, the program supports domestic sugar prices above world levels. Another source of support is the sugar

¹⁹ The first such notification was made by the U.S. government for the years 2002-2005 just after this paper was completed.

²⁰ <http://www.ers.usda.gov/Features/farmbill/analysis/sugar2002act.htm>

loan program, under which USDA makes loans available to sugar processors at a legislated loan rate for sugar pledged as collateral²¹”

Therefore with respect to US reduction commitments on domestic support, it appears that the Flexible Marketing Allotments in the FSRI Act of 2002 constitute a measure in favor of agricultural producers that was introduced following the base period of 1986-88²². H.R. 2419 has gone a step further to remove USDA’s discretion by providing in statute that marketing allotments must be set at a minimum 85 percent of domestic consumption.

Support provided through marketing allotments is a form of income support provided in addition to the benefit conferred by the non-recourse loan program. Marketing allotments do not satisfy the basic criteria of Annex II (Green Box), in that they provide support that is directly related to current prices. In addition, marketing allotments do not appear to be exempted by any other provision of the URAA. Therefore, marketing allotments are not exempt from US reduction commitments and should be reported as a product-specific measure in the Total AMS.

While market price supports and the criteria outlined in paragraph 8 of Annex III provides for WTO Members to maintain price gaps with budgetary outlays such as “buying-in” and storage costs²³, this exemption from reduction commitments should not be construed to allow for WTO Members to increase support, as the case with the introduction of marketing allotments.

Restricting marketing of domestic sugar is a means to an end with respect to increasing US market prices. Rigid control of domestic supply, particularly in conjunction with the import restraints provided by the TRQ, helps to increase, not simply maintain US market prices above forfeiture level. In addition, the US government remains the buyer of last resort.

Section 9016 “Feedstock Flexibility Program for Bioenergy Producers”ⁱ

This section presents serious concerns in that H.R. 2419 is transferring the burden of operating the sugar program at no-net cost to the taxpayer, in a program contained in the bill’s energy title. The Congressional Budget Office Cost Estimate states that the “Feedstock Flexibility Program would subsidize the use of sugar as a feedstock in the production of ethanol.”

²¹ <http://www.ers.usda.gov/AmberWaves/September07/Findings/USSugar.htm>

²² URAA Article 7 Paragraph 2(a): “Any domestic support measure in favor of agriculture producers, including any modification to such measure, and any measure that is subsequently introduced that cannot be shown to satisfy the criteria in Annex 2 (Green Box) or be exempt from reduction by reason of any other provision of this Agreement shall be included in the Member’s calculation of Current Total AMS.”

²³ URAA Annex III paragraph 8: “Market price support shall be calculated using the gap between fixed external reference price and the applied administered price multiplied by the quantity of production eligible to receive the applied administered price. Budgetary payments made to maintain this gap, such as buying-in or storage costs, shall not be included in the AMS.”

Regardless of how the budget is affected, whether categorized as a government outlay for sugar or for producing bioenergy, there will be a significant cost which will not qualify for an exemption from the AMS under URAA rules. The United States will be obliged to report this program as product specific support in the AMS. In addition, the provision does not have a statutory cap on funding; rather, the CCC is directed to provide funding as necessary.

This should be of great concern, since the AMS is limited, and the open-ended nature of this program may further exacerbate the US ability to maintain trade-distorting domestic support below the \$19.1 billion annual limit. In a report conducted by USDA's Office of Chief Economist in July 2006²⁴, USDA estimated that producing ethanol from refined sugar is the most costly production method, compared to using unprocessed sugar crops or raw cane sugar, with production from refined sugar costing an estimated \$3.97 per gallon. This sharply contrasts with the cost of producing a gallon of ethanol from corn wet-milling at a \$1.03, according to the same study.

Regardless of cost, the US will have to report this new policy as a trade-distorting domestic support, which will be included in the US AMS.

Conclusion

The world sugar market is a highly distorted market that presents challenges for any sugar producing, importing or exporting country. The Agreements of the Uruguay Round, including the Agreement on Agriculture, the Subsidies and Countervailing Measures Agreement and the General Agreement on Tariffs and Trade 1994, provided procedures under which WTO Members could subsidize and protect domestic industries, but these agreements also provided basic rules that were intended to make agriculture trade as fair as possible. While distortions remain, and additional rules and reductions are necessary, these distortions are not grounds nor do they justify WTO Members' failure to implement the rules as agreed. Any WTO Member that fails to abide by the rules of the Uruguay Round, should anticipate challenges in the WTO Dispute Settlement Body.

As passed by the House of Representatives, H.R. 2419 appears to place the US sugar program at increased risk for challenges. Such an environment is not sustainable, and change will be forced through retaliation on the United States' most highly competitive exports. Thus, a successful challenge to the sugar program could jeopardize many competitive industries which depend on demand growth in foreign countries, including some high value agriculture exports.

Therefore, these proposed changes to sugar policy should be carefully considered by Congress, the US sugar industry and US agriculture as a whole. No longer can

²⁴ "The Economic Feasibility of Ethanol Production from Sugar in the United States" USDA Office of Chief Economist, July 2006
<http://www.usda.gov/oce/reports/energy/EthanolSugarFeasibilityReport3.pdf>

one industry and the support provided to it be isolated from another. It is in the best interest of US agriculture to acknowledge this reality and make a transition to a proactive position in global agriculture trade, so as to ensure the future viability of the US safety net for agriculture.

ⁱ Congressional Budget Office Cost Estimate of the H.R. 2419: Under the bill, a Feedstock Flexibility Program would subsidize the use of sugar as a feedstock in the production of ethanol. By increasing the demand for sugar, CBO estimates that the bill would reduce the cost of the sugar support program by \$107 million over the 2008-2012 period and \$240 million over the 2008-2017 period. USDA's bioenergy program subsidizes the cost of agricultural feedstocks used to produce ethanol or other biofuels. CBO estimates that amendments made by the bill would increase that program's direct spending by \$1.3 billion over the 2008-2012 period and \$3.1 billion over the 2008-2017 period.