May 23, 2007

Top 5 Reasons Why
A Sugar Loan Rate Increase Is A Bad Idea

1. Federal budget costs for the sugar program will end up at least double the current CBO projection of $1.3 billion and could reach $4 billion.
2. We will lose more food and beverage industry jobs as foreign companies with access to lower cost sugar ramp up their exports of sugar-containing products to the United States.
3. Over the course of a 5-year Farm Bill, a 3-cent increase in the sugar loan rate will be a $3 billion sugar tax on consumers, on top of rising food costs triggered by the ethanol boom.
4. The added incentive to expand sugar beet acreage will lure acres away from corn and soybean production in the Upper Midwest, pushing up feed prices paid by livestock, poultry and dairy producers.
5. A higher loan rate will increase the sugar subsidy levels which the US must report to the World Trade Organization by about 30%. These subsidies are considered "amber" (trade-distorting) support under WTO rules, along with dairy price supports and direct payments for grains, oilseeds and cotton. Producers of these commodities are therefore being asked to give up some of their future share of the diminishing pool of "amber" support so that the sugar industry can have more.

Budget costs

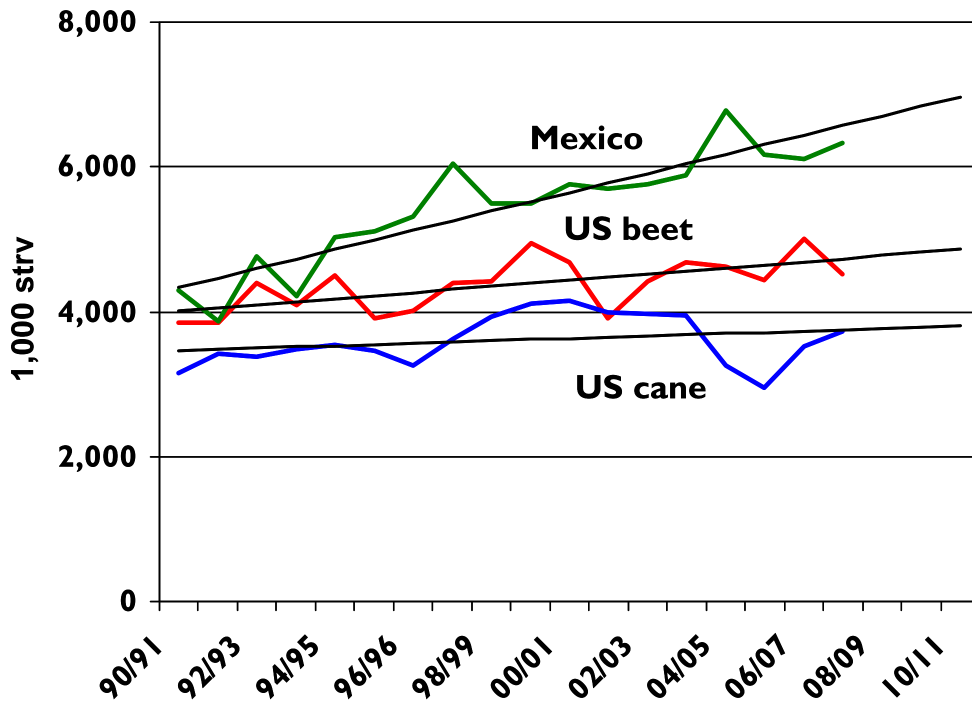
Any increase in the sugar loan rate in farm legislation will have profoundly negative implications for the Federal budget and for the long-term viability of the US sugar industry. The current CBO projection of a $1.3 billion budget cost for the sugar program could more than double to $2.7 billion and even exceed $3 billion.

Budget costs would be larger for two reasons. First, the price support loans on the excess sugar that is forfeited would be larger due to the higher loan rate. Using the rumored loan rate increase of three cents per pound for raw cane sugar, and a comparable increase for refined beet sugar, the average loan would be about 16% larger. This would add over $200 million to budget costs.

More importantly, however, a three-cent increase in market prices would provide a strong incentive to both US and Mexican producers to expand production. Farmers do respond to market signals. The price elasticity of supply for both sugarcane and sugar beets is typically about 0.3. This means that for each 10% increase in price, there will be a 3% increase in production. In this case, starting from a wholesale market price for refined sugar of about 25 cents per pound, a 3-cent higher loan rate would

imply a 12% increase in prices in both countries. With prices 12% higher, production in both countries would expand by 3.6%.

In 2008/09, sugar production in the United States and Mexico under current policy (with allotments triggered off) will likely be 8.5 and 6.5 million strv (short tons, raw value), respectively. If unconstrained, a 3.6% increase in production would be about 300,000 tons in the US and 250,000 tons in Mexico.



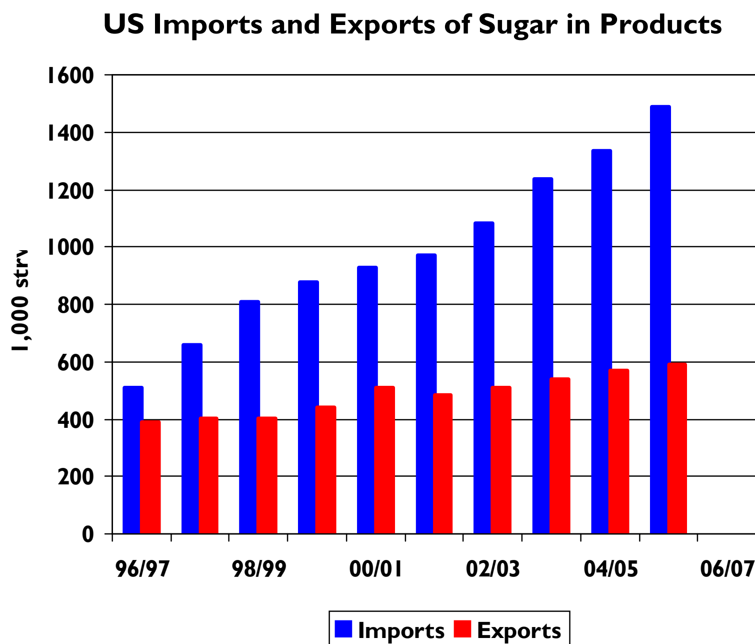
Looking first at the additional 250,000 strv of Mexican sugar, it will have no place to go each year but the US market, raising loan forfeitures by that amount. With a higher cane sugar loan rate of 21 cents and a beet sugar loan rate of about 26 cents, the average loan rate on forfeited sugar will be about 24 cents, or $480 per ton. Thus the Federal budget cost associated with these additional forfeitures would be $120 million per year or $1.2 billion over the 10-year projection period ($480 x 250,000 = $1.2 billion). With the existing baseline cost at $1.3 billion and an additional $200 million due to the higher loan rates on that sugar, the total cost will balloon to at least $2.7 billion, without considering the effects of higher US production. If the additional 300,000 strv of domestic sugar are forfeited, that would add another $1.4 billion to costs, pushing the total to about $4 billion.

Some expect the Farm Bill to contain authority to divert excess sugar to ethanol production. This would create additional budget costs, and also result in reduced tax revenues of $0.51 for every gallon produced from sugar. Alternatively, the Congress may give USDA authority to keep marketing allotments permanently in place so that US sugar production can be held down to make room for

Mexican sugar. USDA's long-term baseline released in February already has US production being constrained in the 7.9-8.5 million ton range from 2008/09 to 2012/13. With greater imports from Mexico, they would have to further limit production to 7.6 – 8.25 million tons to keep total supplies manageable. Thus, while Mexican producers would be pushing production back up to or above the longer-term trend level shown in the chart above, US production would be pushed back down below trend levels. That would not be a healthy development for the US sugar industry.

More job losses

Commerce Department data show that 70,000 jobs in sugar-using industries disappeared between 1997 and 2004. That 10% decline in employment contrasts with a 4% increase in employment over that period in the food and beverage industries that do not use sugar. While the sugar program blocks imports of sugar to keep prices high, trade in sugar-containing products is steadily being liberalized. In the early 1990s the United States was a net exporter of sugar in products. Now we are a major net importer, as illustrated in the following chart. Over 10% of the sugar we consume is now in imported products. Higher sugar prices will accelerate that trend.



Consumer costs

A three-cent loan rate increase will push the market price of sugar up by at least three cents or $60 per ton. We currently consume 10 million tons. Therefore the annual increase in consumer costs would be $600 million, adding up to $3 billion over the course of a 5-year farm bill.

In a study of the effects of the massive investment in fuel ethanol and biodiesel, Iowa State's Center for Agricultural and Rural Development estimated that it has already raised food costs by $14 billion on an

annual basis. Further increases will occur if crops are disappointing this year or if there is continuing escalation in crude petroleum prices. The last thing that is needed is a sugar tax on top of these impacts.

Competition with corn and soybeans

If we give sugar beet producers the incentive to expand production, the acres will come primarily out of corn and soybeans in the upper Midwest. Elsewhere in the country there will be reductions in plantings of other grains and oilseeds, as well as corn and soybeans. Livestock and dairy producers are already under severe pressure from rising feed costs due to ethanol and biodiesel production. A sugar loan rate increase will simply exacerbate the problem.

Sugar will take a bigger share of the "amber box"

Any increase in the sugar loan rate will reduce the flexibility the United States currently enjoys under Aggregate Measure of Support (AMS) commitments agreed to in the Uruguay Round Agreement on Agriculture. And it will negatively impact the other commodities – grains, oilseeds, cotton and dairy – that must compete with sugar within the limited allowed amount of AMS.

A three cent increase in the sugar loan rate would increase the applied administered price charged US sugar by three cents, increasing the per ton amount applied to US production to $440 a metric ton from $375 a ton. Equally serious, a three cent increase would increase the applied administered price to a level **above** $397, the reference price before the US enacted the domestic support reductions mandated by the Uruguay Round Agreement on Agriculture.

A three cent increase in the sugar loan rate increases the AMS spent on sugar by $66 a ton given the URAA reference price. This increase reduces the amount of AMS left for other commodities. For instance, if the three cent increase to the loan rate were applied to the eligible production of the fiscal year for which the United States last notified AMS to the WTO, it would result in the AMS spent on sugar ballooning from $1.03 billion to $1.5 billion. In reality, the 7.2 million metric tons notified to the WTO for the 2001/02 fiscal year was the lowest amount notified since 1996/97. Current US production of 8.5 million short tons is 7.7 million metric tons. A loan rate increase on that volume of production would increase the AMS charged to sugar to $1.6 billion. However, this assumes that the Doha trade round never concludes.

Should Doha conclude, the US will have to apply a different base period to the external reference price. US trade negotiators have advocated the period from 1999-2001 as the new base period. Given this period the external reference price would fall to $179 per ton. In this scenario, and given a three cent increase in the loan rate on sugar, AMS for sugar would increase to $2.0 billion dollars based on current US production.

Thus an increase in the loan rate takes valuable AMS expenditure away from other agricultural products. Under the current AMS commitment level the US is allowed to spend $19.1 billion a year on Aggregate Measure of Support. An increase in the loan rate not accompanied by a Doha agreement increases the proportion of total allowed AMS spent on sugar from 5 percent to 9 percent. However, more alarming is the relative proportion sugar would receive under a reduced AMS ceiling resulting from a Doha agreement. Assuming a 60 percent reduction in total AMS, as proposed by the United States in its October 2005 negotiating proposal, the US AMS limit would be lowered to $7.6 billion. The increased AMS outlay for sugar given a three cent increase in the loan rate would push sugar's share of the total AMS from 13 percent (using the last US notified AMS expenditure on sugar) to 26 percent with a three cent loan rate increase. This drastic shift in favor of sugar crowds out other commodities that also are supported by programs that are used to calculate the AMS.

In light of Canada's pending challenge of the US AMS, Congress should flatly reject any proposed increase in the sugar loan rate which makes the US susceptible to future challenges regarding AMS. Most importantly, an increase in the sugar loan rate crowds out other commodities from the AMS budget, reducing the amount available for support programs that producers of those commodities value highly.