United States Department of Agriculture

Office of the Secretary
Washington, D.C. 20250

September 22, 2006

Mr. Dalton Yancey
President, American Sugar Alliance
Florida Sugar Cane League
2111 Wilson Boulevard
Suite 600
Arlington, Virginia 22201

Dear Mr. Yancey:

Thank you for your letter of August 1, 2006 on behalf of the American Sugar Alliance (ASA) expressing your industry's concerns about the July 27, 2006 announcement regarding the U.S. sugar program for FY 2006 and FY 2007 and our agreement with Mexico on market access for sweeteners. We believe that the agreement and actions announced on July 27 are in the best interests of the entire agricultural community and our Nation. Our actions address a clear need for additional imports to ensure a balanced FY 2006 and FY 2007 domestic sugar market, avoid potential market disruptions and facilitate a smooth transition to full duty-free trade in agricultural commodities with Mexico under the North American Free Trade Agreement (NAFTA).

It is important to recognize the larger overall context in which we are taking decisions for this and next year's sugar program. This past year is widely acknowledged as perhaps the most turbulent and disruptive for the sweetener industry in over three decades, leaving us to face yet another period of very considerable uncertainty. Sugar analysts agree on one critical point: with stocks projected to be severely depleted in FY 2007, the U.S. market will need a substantial amount of imported sugar to adequately meet FY 2007 needs and provide adequate carryover for FY 2008. USDA, in its July 2006 World Agricultural Supply and Demand Estimate (WASDE) report, projected ending FY 2007 stocks at only 0.979 million tons, considerably below what USDA feels is reasonable carryover.

Given this market reality, it makes imminent good sense to obtain the needed sugar in a way that can significantly benefit U.S. agriculture broadly and our trade specifically in the NAFTA sweetener industry. Therefore, we reached an agreement with Mexico to obtain some of the required sugar from Mexico in return for something the United States has long sought: expanded market access for U.S. high fructose corn syrup (HFCS).

An Equal Opportunity Employer

The paragraphs below further address your specific concerns regarding the domestic sugar program and the agreement with Mexico.

Domestic Sugar Supply

One of the concerns you expressed is that the overall amount of imports resulting from our actions will "oversupply and disrupt" the domestic sugar market. We believe exactly the opposite to be the case.

Foremost, the sugar provided by our announcement was based on an analysis of domestic sugar market needs per the July WASDE report. The July WASDE report projected FY2007 use of 10.6 million ton; and assuming reasonable ending stocks of 1.6 million tons and projected domestic supply at 9.8 million tons, imports needed to total 2.4 million. However, FY 2007 domestic supply was projected at 9.776 million tons – 1.431 million tons of carry-in and 8.345 million tons of domestic production – leaving a shortfall of 2.439 million tons to be supplied by imports. The July WASDE forecast the additional supplies expected under our minimum trade commitments – 1.818 million tons. This still left an unmet need of 621,000 tons. Some of this need will be met by the additional FY 2006 imports provided for in the July 27 announcement, which can be carried-over to FY 2007. We intend to meet the remainder of this need through our agreement with Mexico and the FY 2007 raw sugar TRQ increase.

Moreover, our intent is to continue to operate the sugar program within the parameters Congress provided. "Oversupply," in the context of the sugar program, would result in forfeiture of sugar pledged as collateral in the nonrecourse loan program. However, USDA did not project any loan collateral forfeitures in either FY 2006 or FY 2007 as a result of increasing imports as announced in the July 27 press release. Moreover, beginning January 1, 2008, remaining tariffs on sugar from Mexico go to zero, which may necessitate modification of the sugar program.

The nature of a highly complex supply control program regularly requires USDA to make major decisions under great uncertainty that can have significant market implications. For example, USDA is required to determine the FY 2007 domestic sugar supply before any 2006-crop beets or cane have been harvested. However, information available to us at this time indicates that our actions can reasonably be expected to provide an adequate supply, and not an oversupply. And, as you noted, the supply expected to result from our actions is well within the traditional "acceptable" range.

You also expressed concern that an ending stocks-to-use ratio of 15 percent will result in oversupply. We recognize that, in general, transportation and storage efficiencies have allowed smaller stock holdings than in the past. While the industry has been consolidating and may have been gravitating to a "just-in-time" inventory system as you suggest, such movement suffered a serious setback in August 2005, when one of the few sugar marketers announced that it would have to renege on contractual commitments because of inadequate supply. This sent shock waves through the user community. That one event alone forced many to reassess their stockholding policy. And, then, added to that, were the weather events of 2005, which not only reduced domestic production, but also disrupted processing operations, further demonstrating to the industry and USDA the precariousness of existing supply strategies. USDA is following the lead of many of ASA's members who have altered their supply strategy to increase supplies in late summer, when markets are most susceptible to disruption by a poor early beet crop or hurricanes. All things considered, we believe we would have been short-sighted to ignore the recent performance of the sugar market and to provide less than adequate supplies, including stocks below reasonable levels.

You also raise concerns about the elimination of shipping patterns for FY 2007. USDA eliminated shipping patterns for FY 2007 because of refiner concern that the tight FY 2006 world sugar market will affect the normal availability of raw sugar stocks at the start of the fiscal year. Eliminating shipping patterns for FY 2007 allows flexibility for raw sugar supplies during a time of year prior to the start of harvest in many large quota-holding countries, and prior to the peak season of domestic raw sugar production.

Your letter also cited the decline in raw sugar futures price following the July 27 announcement as an indication of oversupply. The market did fall a penny on the day of the announcement but within three days had regained half of that amount. Current raw prices remain above the level that would encourage cane processors to forfeit loan collateral. It is also worth noting that the July 27 announcement increased the FY 2006 refined sugar tariff-rate quota (TRQ) amount at least as much as the raw sugar TRQ amount, yet FY 2006 refined prices remain well above the level that would encourage beet processors to forfeit loan collateral.

You further note that the announced actions will increase access for imported sugar while some domestic beet sugar potentially could be blocked from sale. As you well know, this outcome is the direct result of language in the 2002 Farm Bill that expressly prohibits the reassignment of a deficit in the cane sugar allotment to the beet sugar sector. Instead, the 2002 Farm Bill requires USDA to reassign any surplus cane allotment to imports. Even so, for FY 2007, any effect of this provision will be very small. USDA would expect the amount of any beet blocked stocks to approximate the amount that beet processors would need for year-ending stocks. Thus, further increase in the FY 2007 beet sugar allotment would not be expected to result in any additional sugar actually being delivered to the market.

Trade with Mexico

Your letter expressed concern that the agreement and actions noted in the July 27 announcement will undermine an "orderly transition" to duty-free sweetener trade with Mexico in January 2008 when all duties are eliminated. Needless to say, we come to an entirely different conclusion. We believe the agreement and announced actions will in fact facilitate an orderly transition to full implementation of the NAFTA in 2008. By creating more consistent conditions for Mexico to supply sugar to the U.S. market between now and 2008, we reduce the opportunity for dramatic changes in trade flows when NAFTA is fully implemented. Increasing duty-free trade with Mexico now helps to reduce Mexican stocks in advance of the post-January 1, 2008 period. Moreover, the agreement creates a joint industry/government task force to monitor trade procedures and shipments and thereby assist the governments to prepare for duty-free sweetener trade in January 2008.

You assert that we did not follow the NAFTA side letter by not using published USDA data on the Mexican sweetener market and signaling 1st quarter FY 2008 Mexican duty-free access at this time. We point out the side letter does not specify a particular data source for the net-surplus producer determination. With respect to FY 2007, USDA based its net-surplus producer determination for Mexico on Mexican government sugar production forecasts and USDA forecasts for HFCS and sugar consumption.

We agree that it is too early to make the net-surplus producer determination for Mexico for FY 2008 based on the NAFTA side letter. However, current forecasts suggest that Mexico will again qualify as a net-surplus sugar producer for FY 2008. If these forecasts change, there are other authorities the United States may use to grant Mexican sugar duty-free treatment for the 1st quarter of FY 2008.

You also assert that the agreement benefits Mexican sugar producers and U.S. HFCS producers, but does not facilitate an orderly transition for U.S. sugar producers to duty-free trade with Mexico. We believe the agreement provides significant benefits for the U.S. sugar industry. First, per your request, the agreement secures U.S. sugar producers' right to access to the Mexican market. Specifically, Mexico will provide duty-free access to 7,258 metric tons of U.S. sugar for each of FY 2006, FY 2007 and FY 2008. This allows the U.S. sugar industry to begin establishing business relationships for the post-January 1, 2008 period. Moreover, the agreement reaffirms Mexico's commitment to eliminate any over-quota tariff or import licensing procedures applicable to U.S. sugar imports by January 1, 2008.

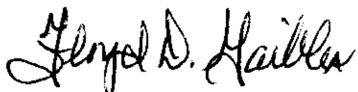
We believe the agreement also benefits U.S. agriculture more broadly. First, it benefits U.S. sugar consuming industries, which as noted above, without access to imported sugar would face a significant supply shortfall. Second, it secures substantial benefits for U.S. corn refiners, corn growers, and rural areas. (And, the corn refiners, as you know, would

suggest this is small recompense for the benefits they have so long been denied under the NAFTA.) For example, USDA analysts indicate that the export of potentially 500 million metric tons of HFCS would require 28 million bushels of corn, which in today's market could have a price impact of a penny or more per bushel meaning an overall boost in revenue to corn growers of well over $100 million.

Summary

We believe that the agreement with Mexico and the actions announced on July 27 are appropriate and in the best interest of all stakeholders involved. The agreement and announced actions take into account current USDA projections of U.S. sugar supply and demand, market conditions in Mexico, and the reality that beginning on January 1, 2008 sweeteners trade between the United States and Mexico will be duty-free. The agreement and announced actions are also consistent with the U.S. sugar program requirements and the NAFTA. We look forward to continuing to work with all segments of the sugar and sweetener industry and thank you for expressing your views regarding our recent announcement.

Sincerely,



Floyd D. Gaibler
Acting Under Secretary
Farm and Foreign Agricultural Services

Richard T. Crowder
Chief Agricultural Negotiator
Office of the United States Trade Representative