SWEETENER USERS ASSOCIATION

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STATEMENT OF THE SWEETENER USERS ASSOCIATION AND THE COALITION FOR SUGAR REFORM

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Introduction

The Farm Security and Rural Investment Act of 2002 (the FSRIA), P.L. 107-171, reinstated and revised sugar marketing allotments. Sweetener users opposed the provisions of the FSRIA that enacted these policies. However, allotments are the law under the new farm bill, and the U.S. Department of Agriculture (USDA) is charged with implementing them in a reasonable manner.

The Sweetener Users Association (SUA) and the Coalition for Sugar Reform (CSR) commend USDA for calling a public meeting to discuss U.S. sugar policy and sugar program administration. The two groups applaud USDA's sincere desire to set sugar policies in a more transparent, open and balanced manner. In this paper, we have attempted to set forth some constructive suggestions both for the substance of policy, and for the means by which it is administered and by which the public has an opportunity to participate in its formulation.

The **Sweetener Users Association (SUA)** comprises companies in the confectionery, food manufacturing, cereal, soft drink and similar industries that utilize nutritive sweeteners in their business operations, as well as trade associations representing the interests of these companies. **The Coalition for Sugar Reform (CSR)** includes many of the same associations, but also includes sugarcane refiners and consumer, environmental, and taxpayer-advocacy groups, all of whom share an interest in reforming U.S. sugar policy.

Program Administration, Public Participation and Transparency

Background

Under amendments to the Agricultural Adjustment Act of 1938 (the 1938 Act) made by the FSRIA, USDA establishes and enforces **marketing allotments** for cane and beet processors. Allotments are established for the cane and beet sectors and then applied to individual companies, under rules that differ for the two commodities. The combined cane and beet allotments are known as the **Overall Allotment Quantity (OAQ).** The OAQ for 2002/03 was first announced on August 27, 2002, at 7.7 million short tons, raw value (STRV). SUA, CSR and other organizations and companies criticized the OAQ as unnecessarily low, and expressed strong concern that the OAQ would not make sufficient supplies available to the marketplace.

On January, 10, 2003, USDA responded to SUA and CSR's concerns by increasing the OAQ to 8.2 million STRV. Simultaneously, USDA announced that it would dispose of all remaining sugar in the inventory of the Commodity Credit Corporation (CCC). This sugar had been acquired through forfeitures of price support loans in 1999/2000. As of early March, USDA had completed the disposal of CCC-owned sugar and held no inventory.

"Reasonable" Ending Stocks for the OAQ Determination

In its January 10, 2003, announcement increasing the Overall Allotment Quantity, USDA appears to have arrived at its revised OAQ through the following calculation, using numbers from the January 2003 *World Agricultural Supply and Demand Estimates (WASDE).*

Table 1
Calculation of Overall Allotment Quantity

(1,000 short tons, raw value)

Consumption (Domestic Food Use)	9,600
Plus Reasonable Carryover Stocks	1,408
Minus Statutory Import Allowance	1,532
Minus Beginning Stocks	1,276
Equals Overall Allotment Quantity	8,200

All the numbers except the reasonable carryover stocks target are publicly available, so one can solve for the stocks target (1,408) and infer that USDA believes that a stocks-use ratio of **14.5%** (1,408 divided by the January total use estimate of 9,725) is "reasonable."

This ratio is much closer to being "reasonable" than the extremely low target implied in USDA's original August 27, 2002, OAQ announcement. Then, the Department seemed to be asserting that a stocks-use ratio of around 11% was reasonable, despite the lack of justification for this number.

However, even a 14.5% stocks-use target is low. The table below provides the stocks-use ratio and the free stocks-use ratio for sugar over the 23-year period since 1980/81. "Free" stocks are those readily available to the marketplace, and described as "private" stocks in USDA's supply-demand tables prior to 2002/03. [1]

[1] Beginning this season, the "private" stocks may also include "blocked" stocks, that is, those supplies which cane and beet processors hold but are not permitted to market during the marketing year because doing so would cause them to exceed their allocations under the marketing allotment program. "Blocked" stocks are in some ways even less accessible to the marketplace than CCC-owned stocks (for example, unless the OAQ is increased, there is no price high enough to permit them to be sold). Therefore, an appropriate definition of "free" stocks henceforward should exclude these

Table 2
U.S. SUGAR STOCKS-USE RATIOS, 1980/81 – 2002/03

SOURCE: U.S. Department of Agriculture[2]

Fiscal Year	Ending Stocks-Use Ratio	Ending Free Stocks-Use Ratio
1980/81	14.7	14.7
1981/82	17.4	17.4
1982/83	15.3	15.3
1983/84	17.7	17.7
1984/85	20.5	19.5
1985/86	19.4	17.1
1986/87	16.6	16.6
1987/88	15.2	15.2
1988/89	14.0	14.0
1989/90	13.2	13.2
1990/91	16.0	16.0
1991/92	15.5	15.5
1992/93	17.7	17.7
1993/94	13.7	13.6
1994/95	12.6	12.6
1995/96	15.1	15.1
1996/97	14.9	14.9
1997/98	16.8	16.8
1998/99	16.0	16.0
1999/2000	22.0	19.0
2000/01	21.0	13.4
2001/02	12.3	10.3
2002/03 (Feb. 03 Projection)	14.6	12.3 [3]
23-Year Average	**16.2**	**15.4**

From the table, we can observe that –

- USDA's chosen 14.5% target is **1.7 percentage points lower than the average** total stocks-use ratio of 16.2% for the entire period.
- USDA's target is almost **a full percentage point lower than the average** free stocks-use ratio of 15.4% for the period.

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supplies, and our estimate for 2002/03 does so, although USDA has not yet broken out its 2002/03 ending stocks estimate in this way.

[2] 2002/03 stocks are calculated from February 2003 WASDE.
[3] Assumes 217,000 tons of "blocked" cane stocks, basis February WASDE estimate of 3.960 million short tons of cane production less cane allotment of 3.743 million short tons.

- During the entire 23-year period, there were **only five years** when the total stocks-use ratio was less than 14.5%, and **only seven years** when the free stocks-use ratio was less.

Therefore, if a "reasonable" stocks-use ratio should be one that is representative of marketplace behavior over a long period of time, 14.5% appears inappropriately low.

If "reasonable" is taken to mean a level that will prevent forfeitures, there is still not a convincing case that the level needs to be as low as 14.5%. Of the 23 years in our analysis, CCC ended the marketing year *without* any stocks in 16 (not counting 2002/03, which is not yet complete). Of these 16 years, the stocks-use ratio **was above 14.5% in 13** (81% of the time).

We suggest, instead, that USDA adopt the following principles:

- First, a reasonable ending stocks target **should be set with a view toward those marketing years in which forfeitures did *not* occur.** If we examine years in which CCC did not take ownership of sugar, we should get some notion of an ending stocks figure that is sufficiently balanced as to discourage forfeiture.
- Second, a reasonable ending stocks target should **represent the desirable level of ending *free* stocks to use.** It should be USDA policy to make adequate supplies available to the marketplace, and therefore the Department's goal should be a stocks level that is entirely available for domestic use.

Applying these two principles to the 1980/81-2002/03 series is instructive. To consider what total stocks level was low enough to discourage forfeiture, we *excluded* the four fiscal years in which forfeitures occurred – 1984/85, 1985/86, 1993/94 and 1999/2000. (We *included* fiscal years in which the government held some stocks but did not take on any additional stocks through forfeiture.) We also *excluded* 2002/03 because the fiscal year is incomplete and so the exact mix of ending stocks is not yet known. For the remaining 18 fiscal years, the average ending *total* stocks-use ratio was **15.7%.**

Next, we looked at *free* stocks during the 1980/81-2002/03 period. Using the same 18 years of the 23-year series, the average ending free stocks-use ratio was **15.1%.** However, one can plausibly argue for considering all 23 years in this comparison, because free stocks by definition exclude CCC stocks. The market needs a certain amount of stocks, and over time price signals will tend to encourage enough stocks to remain in private hands so that gross market distortions will be avoided. This logic would suggest simply looking at the level of free stocks that have actually existed, whether CCC was taking over sugar or not. It turns out this number is quite similar: a **15.4%** average ending free stocks-use ratio for 1980/81-2002/03. If one excludes the current 2002/03 season since the composition of ending stocks is not yet known, the 1980/81-2001/02 average is **15.5%.**

A "reasonable" stocks-use target of about 15.5% therefore seems appropriate, from the standpoint of –

- **Setting a prudent total ending stocks-use ratio to avoid forfeitures;**
- **Taking into account actual free stocks-use ratios that resulted from the operation of the marketplace over the years;**

- **Recognizing prior USDA practice (under the last Administration, an ending stocks-use ratio of more than 15.5% led to the cancellation of a tranche of imports under the tariff rate quota [TRQ], so that there is precedent for using this number as a proxy for adequate supplies); and**
- **Ensuring adequate supplies to the marketplace and avoiding the kinds of market disruptions that characterized the first six months of USDA's operation of the allotment program.**

Just as an excessively high estimate for reasonable ending stocks would favor buyers over sellers, there is no question that the actual numbers used for reasonable ending stocks last summer and fall unfairly favored sellers over buyers. The bargaining power of sellers was enhanced at the expense of buyers, because the former were able to use the U.S. government's announced OAQ as leverage over their customers. Price movements immediately after the OAQ announcement vividly demonstrated this shift in bargaining power.

With all these considerations in mind, we strongly urge USDA to determine that a 15.5% ending stocks-use ratio is "reasonable" for purposes of calculating the OAQ, and publicly announce this determination.

<u>**Other Issues in OAQ Administration**</u>

The FSRIA provides for periodic review of the OAQ. USDA must re-estimate various supply-demand parameters at least quarterly. The **law requires allotments to be adjusted up or down** on the basis of these re-estimates, though there is considerable leeway in how often or when USDA must do so. A new issue of *WASDE* appears monthly, but there is no requirement to change the OAQ each month – nor, for that matter, any prohibition against doing so.

We believe there are two extremes to be avoided in adjusting the OAQ. **Overly frequent adjustments** would risk disruption to the market, compromising the ability of both buyers and sellers to arrange for spot and advance purchases, establish marketing plans and execute hedging programs. On the other hand, **adjusting the OAQ with insufficient frequency** would lead to program rigidity, undue market focus on anticipating USDA's intentions, and disruptions in the ability of buyers and sellers to consummate transactions.

With these considerations in mind, **we recommend that USDA determine – and announce – that it will review the OAQ when the stocks-use ratio is projected at less than 14.5%, and more than 16.5%. This range will ensure that USDA reviews changing supply and demand estimates on a timely basis, but will avoid constant and perhaps premature changes in the OAQ.** Of course, USDA should be more and more reluctant to *decrease* the OAQ as the fiscal year progresses. At some point in the year, enough of the crop has been marketed that while an increase in the OAQ would be feasible, a decrease would not.

In addition, we recognize that the Secretary of Agriculture has authority under the FSRIA **to adjust the OAQ** once it has been established using the statutory formula. Under the law, however, the *only* permissible reason for such an adjustment is to "avoid the forfeiture of sugar to the Commodity Credit Corporation."[4]

In the interest of transparency, **we recommend that –**

- **USDA publish the initial OAQ derived from the statutory formula, prior to any adjustments;**
- **USDA establish a procedure to consult with affected users, consumers, refiners, processors, growers and others before making any adjustments; and**
- **USDA publish a detailed explanation, including economic projections and scenarios, in support of any adjustment to the formula-derived OAQ.**

More broadly, we believe that USDA should establish a process for regular and meaningful consultation with all interested parties, to provide information and obtain public views on the range of sugar program administrative issues. Such a process is especially necessary in sugar, where domestic program decisions tend to affect trade policy, and vice versa.

Summary and Recapitulation of Recommendations

In summary, SUA and CSR offer the following recommendations for long-term administration of the sugar program. We believe that USDA should --

1. Establish a 15.5% ending stocks to use ratio as the target for "reasonable ending stocks" under the FSRIA formula;

2. Review the OAQ when the stocks-to- use ratio is less than 14.5% or more than 16.5%;

3. Establish a goal that all ending stocks should be free stocks fully available to the market, consistent with the FSRIA's directive to avoid forfeitures;

4. Identify and define all of the factors, calculations, and estimates to be considered in making all OAQ decisions, including those required by Secs. 359b and 359c of the 1938 Act as well as those that may be utilized to adjust the OAQ to avoid forfeitures;

5. Provide public notice of these OAQ estimates and calculations for a reasonable period of time prior to taking action to establish or adjust the OAQ;

6. Require OAQ announcements to explicitly identify all of the factors, calculations, and estimates used in calculating or adjusting the OAQ, including any adjustments made to the OAQ pursuant to Sec. 359c (b)(2) of the 1938 Act to avoid forfeitures, to discuss the factors deemed relevant to the analysis of potential forfeitures, and to identify the proportion of the adjustment attributable to each factor; and

7. Create and maintain a meaningful consultative process for OAQ decisions, so that the private sector can contribute information and be informed of USDA's thinking. This

[4] 7 U.S.C. 1359cc, as amended by P.L. 107-171, May 13, 2002.

process should include in this process industrial users, cane refiners, consumers, producers, processors, market analysts and academic experts.

Specific Program Recommendations for 2002/03[5]

The preceding recommendations, though applicable to the current season, have a longer-term focus. Several outstanding issues remain, however, with respect to the program this year. SUA and CSR offer the following comments on program administration during the remainder of 2002/03.

1. We **commend USDA for increasing the OAQ** by 500,000 STRV in January. We urge continued review of the OAQ with a **15.5%** rather than a 14.5% stocks target as a benchmark.
2. We also **commend USDA for completing the liquidation of CCC-owned sugar**. With September domestic sugar futures trading at 22.4 cents per pound, no one can credibly claim that disposing of the stocks has been negative for prices.
3. Now that the fiscal year is nearly half complete, USDA should **ascertain in a timely manner whether a deficit exists in the ability of beet processors to market their allocations**. The March *WASDE* production estimate of 4.215 million STRV for beet production, compared to the beet sugar allotment of 4.457 million STRV, **suggests a deficit of 242,000 STRV**. This number is an approximation because the situations of each beet processing company may be different. However, we note that since 2001/02 ending sugar stocks were drawn down to bare-bones levels (approximately 10% of use, the tightest free stocks-use ratio in at least 23 years), it is a relatively safe assumption that processors' marketings will largely be limited to current production. We also believe it has now become urgent that USDA make this calculation, and take the follow-up actions required by law and described in item 4 below, as soon as possible. The cut in beet sugar production of 85,000 STRV projected just yesterday illustrates a need for additional supplies in the marketplace.
4. With no stocks remaining in CCC inventory, the FSRIA requires that any beet deficit be reallocated to increases in the TRQ. Therefore, we urge that as soon as practicable, **USDA increase the TRQ by an amount equal to any beet sugar deficit** (see item #3 above). Once again, we believe this step needs to be taken as soon as possible in light of the March *WASDE*'s downward revision in beet sugar production. A further increase in the OAQ may also now be appropriate.
5. Finally, we urge that USDA **begin public discussions about both the TRQ and the OAQ for 2003/04** in a timely manner; that the Department also adopt a 15.5% target for reasonable ending stocks during 2003/04; and that USDA publish various alternative scenarios for the OAQ and the TRQ and take public comment on these alternatives.

Conclusion

The U.S. sugar program is far from perfect. SUA and CSR have sought, and will continue to seek, reforms in the program's structure. However, we understand that USDA's flexibility in program administration is limited to the discretion granted to the Department in statute. Fortunately, this

[5] This section of the paper has been updated to reflect the March WASDE, released the day before USDA's public meeting.

discretion is substantial in some areas. We believe the Department should administer the program to be as market-oriented as possible, in as open a manner as possible.

The sugar market is characterized by substantially more government involvement than are the markets for most other commodities. This means that market participants must add the vagaries of federal policies to those of supply and demand as they attempt to assess current conditions and anticipate future developments.

In this context, it is better for government policy to be made more openly rather than less; for government consultations to be more inclusive rather than less; and for government decisions to favor more flexibility for market participants, rather than less. It is in the spirit of encouraging such a policy orientation that these comments are submitted, and we appreciate the opportunity to do so.