THE MORAL LIBERAL

U.S.-Mexico Sugar Agreement: A Tribute to Managed Markets

By Daniel R. Pearson
October 31, 2014

The U.S. Department of Commerce (DOC) announced Oct. 27 that it had reached draft agreements with Mexican sugar exporters and the Mexican government to suspend antidumping and countervailing duty (AD/CVD) investigations on imports of sugar from that country. Commerce has requested comments from interested parties by Nov. 10, with Nov. 26 indicated as the earliest date on which the final agreements could be signed. Given the obvious level of consultation by governments and industries on both sides of the border leading up to this announcement, it's reasonable to presume that the agreements will enter into effect within a few weeks.

Suspension agreements that set aside the AD/CVD process in favor of a managed-trade arrangement are relatively rare. They sometimes are negotiated when the U.S. market requires some quantity of imports, and when the implementation of high AD/CVD duties would be expected to curtail trade severely. This would have been the case, assuming the duties actually had entered into effect. However, as this recent blog post indicates, it's not at all clear that the U.S. International Trade Commission (ITC) would have determined that imports from Mexico were injuring the U.S. industry. A negative vote (a vote finding no injury) by the ITC would have ended these cases and left the U.S. market open to imports of Mexican sugar.

What are the key provisions of the agreements? There are restrictions on both the price and quantity of imports from Mexico. Sugar will only be allowed to be imported into the United States if it is priced above certain levels: 20.75 cents per pound (at the plant in Mexico) for raw sugar, and 23.75 cents per pound for refined sugar. (For comparison, U.S. and world prices for raw sugar currently are about 26 cents and 16 cents, respectively; for refined sugar about 37 cents and 19 cents.) Additional price controls on individual Mexican exporters based on their alleged prior dumping (selling at a price the DOC determines to be less than fair value) will further raise the prices at which they will be allowed to sell.

Quantity restrictions on imports will be imposed through a formula related to supply and demand conditions in the U.S. market. A knowledgeable sugar industry analyst has calculated that Mexican exporters would be allowed to sell a minimum of approximately 1.3 million metric tons raw value (MMTRV) during the 2014-15 marketing year (Oct. 1, 2014 to Sept. 30, 2015). Depending on market conditions next spring and summer, that figure may rise to around 1.45 MMTRV. (Over the past seven years, imports from Mexico ranged between 0.629 MMTRV and 1.927 MMTRV.) No more than 60 percent of Mexico's exports may be in the form of refined sugar. The timing of import arrivals will be controlled. Mexico will utilize

export licenses to prevent more than 30 percent of its allowed sales from arriving in the United States during the October-December quarter, and no more than an additional 25 percent during January-March.

Since 2008 when NAFTA's sugar provisions were fully implemented, there has been an open border for bilateral trade in sweeteners. Now that trade will be subject to a tightly controlled regime in which both governments will play important roles in making sure that market forces are not allowed to operate.

Who are the likely winners and losers from this new arrangement? As might be expected, the U.S. sugar industry got pretty much everything it wanted. Both price and quantity will be constrained in ways that keep the U.S. market isolated from the world. U.S. growers can be expected to continue to enjoy artificially inflated earnings.

Mexican growers got perhaps half of what they wanted. True, they have at least temporarily given up the open access to the U.S. sugar market that was negotiated under NAFTA. However, they have staved off what may have been the complete loss of their most important export market, in the event the ITC had ruled against them. They have obtained guaranteed access for slightly more than the quantity of sugar that had been exported to the United States on average in the seven years since NAFTA's full implementation. And, as an additional benefit, the price restrictions imposed by the DOC will mean that they are likely to sell at higher prices in this managed market than would otherwise have been the case.

Officials in the U.S. Department of Agriculture (USDA) who run the sugar program also likely see themselves as benefitting from the suspension agreements. They have the rather unenviable task of trying to manage sugar supplies from all sources. This not only includes imports from the 41 countries that have rights to export sugar to the United States under the tariff-rate quota (TRQ) system. It also encompasses commercial deliveries of sugar produced by U.S. growers, who accepted marketing limits years ago in order to retain their high level of government price support. Up until now, the only unregulated source of supply to the U.S. sugar market has been imports from Mexico. Managers of the U.S. market may find it easier to maintain a tight enough balance between supply and demand to prevent the price from falling to the support level. Low domestic prices lead to costs for USDA, which no doubt generates flak for the people running the program. (Note: Making it easier for officials to supplant the invisible hand of the marketplace likely wouldn't be seen as a good thing by the late free trader, Adam Smith.)

It's not hard to identify losers from a tightly managed U.S. marketplace. Anyone who uses sugar is paying more for it than it is worth in the outside world. A press release by the Sweetener Users Association indicates their concerns that additional import restrictions will lead to greater market uncertainty and higher prices. Consumers can expect to pay hundreds of millions of extra dollars per year for sugar-containing products. This cost increase will act like a regressive tax. Low-income people will forfeit a higher percentage of their incomes to pay for this new consumption "tax" than will people with relatively higher incomes. (Will the White House criticize the deal because it leads to greater inequality?)

Another likely group of losers are U.S. producers and exporters of high-fructose corn syrup (HFCS). The United States generally is believed to be the world's lowest-cost producer of HFCS, which has become the preferred sweetener for soft drinks and other liquid applications in North America. U.S. exports of HFCS to Mexico have risen more than three-fold since 2007 and recently have amounted to a million metric tons per year. (Liberalization under NAFTA has led to active sweetener trade in both directions.) The suspension agreement generates uncertainty for HFCS producers because sugar that otherwise would have been exported from Mexico to the United States now may stay south of the border and be used instead of HFCS in soft drinks. It would not be surprising to see a notable decline in HFCS exports in the coming years.

On the other hand, Mexico had made clear its intention to retaliate in some form in the event AD/CVD duties were implemented against sugar, with HFCS being a likely target. (Note: Such retaliation likely would not be consistent with Mexico's obligations under NAFTA and the WTO, but those commitments have not been much of a restraint in the past. The history of bilateral sweetener disputes provides ample evidence of Mexico's ability to discriminate against imports of HFCS.) Thus, the U.S. HFCS industry may be hurt less by the suspension agreement than it would have been hurt by Mexico's reaction to an adverse decision at the ITC. (Why is it that efficient industries often seem to suffer harm when governments try to protect inefficient industries?)

Of course, the U.S. and Mexican economies also will be losers under the settlement agreement. Both will tend to see scarce resources being allocated more poorly. GDP will be lower in each country, although minimally. Since the effects will be small, should we be concerned? The main concern is that this is one more among many policy choices in which the U.S. government has sided with special interests at the expense of the public interest. Could that be a reason that the economy has struggled to get back on its feet?

Which leads to the final loser: U.S. international trade policy. The United States currently is negotiating trade agreements including the Trans-Pacific Partnership (TPP), the Trans-Atlantic Trade and Investment Partnership (TTIP), and (at least still in theory) the World Trade Organization (WTO) Doha Round. Does making a public statement to the effect that protecting U.S. sugar growers is the central organizing principle of U.S. trade policy do anything to strengthen the hand of U.S. negotiators? Hardly. Rather, the suspension agreement with Mexico likely will make it more difficult to persuade Japan to eliminate tariffs on its sensitive agricultural products. Our Canadian neighbors are being challenged in the TTP to end their highly restrictive dairy and poultry programs. What kind of message does the sugar suspension agreement send to them? It might be best if U.S. trade policy was simply to take two aspirin and go to bed until 2017.

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