AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
http://ageconsearch.umn.edu
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

2007 Agricultural Outlook Forum
Friday March 2, 2007

TRANSITIONING INTO A COMMON SWEETENER MARKET WITH MEXICO

Paul Farmer
President, CSC Sugar LLC
New Canaan, CT

Bio: Paul Farmer has worked in the sugar trading business for 30 years. He is currently the President and Managing Director of CSC Sugar LLC. CSC Sugar LLC was created in 2004 when it was formed as a joint venture between Commodity Specialists Company and himself. Prior to CSC Sugar LLC, he managed the sugar trading business for Commodity Specialists Company and The Pillsbury Company, since 1990. He joined Pillsbury in 1990 when it purchased the New York sugar trading business of Phibro LLC, where he had been working since 1985.

CSC Sugar is one of the largest suppliers of raw sugar to the US cane refineries, as well as the largest exporter and importer of refined sugar to and from the USA.

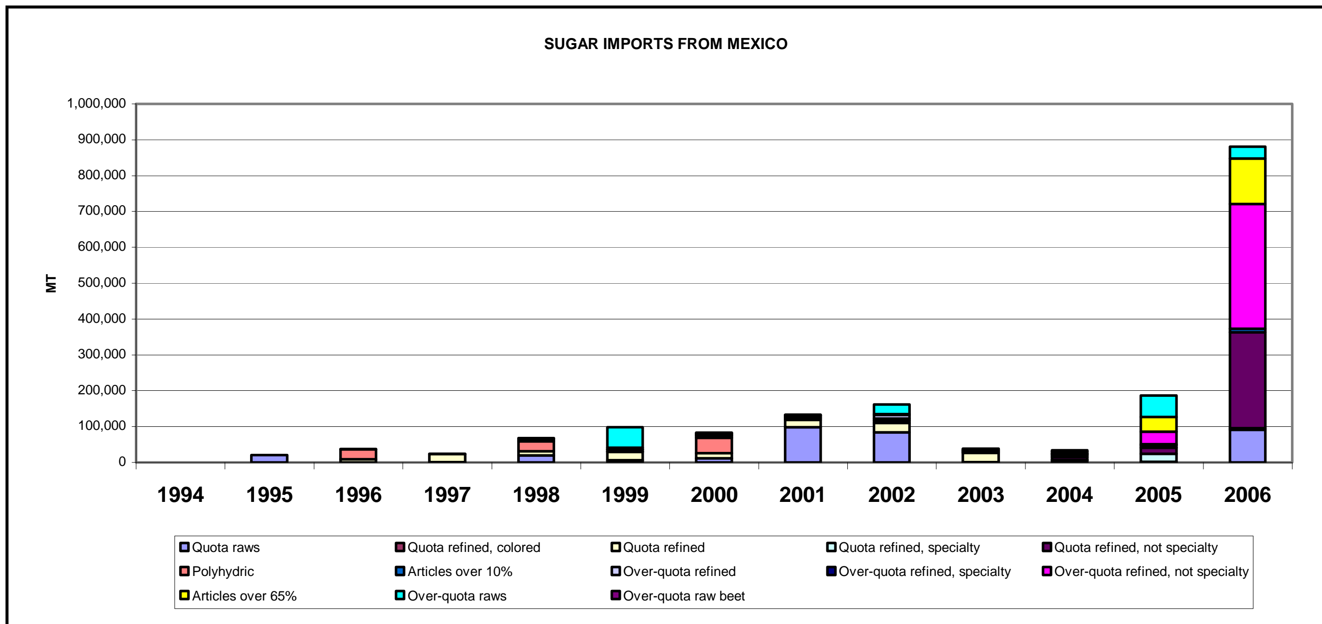
Speech:

Merging of the sugar markets seems to be coming on so quickly, even though we all have had over 12 years to prepare. Few suppliers and users on either side have prepared well, and there are numerous reasons why. Although the NAFTA treaty was written to have a transition period of 15 years with a gradual reduction in import tariffs, the transition has been anything but gradual.

The flow of sugar across the border has always been a contentious issue between our governments as well as the industries as a whole. Uncertainty about quota sizes and the threat of Anti-Dumping suits have kept most serious long term players from allocating resources to the coming merger.
Prior to the implementation of NAFTA, most of the trade consisted of raw sugar moving north to the USA under quota, and refined sugar moving from the USA to Mexico when Mexico had shortages. Since the implementation of NAFTA, the direction of the flow has been mostly north, excluding the sugars destined to the maquiladoras. Refined sugar has been moving into the USA from Mexico since 1997 in reasonable quantities with mixed results. Most of the Mexican refined imports to date have ended up in the hands of liquid sugar manufacturers, as they have been the industry sector capable of handling the packaging and quality issues. Most other US buyers simply do not want woven plastic bags that weigh 110 pounds when the industry standard is bulk rail cars or 50 lb paper bags stretch wrapped on pallets.

Inconsistent supply of Mexican refined sugar over the years has also dampened interest from buyers as any benefits from lower pricing have been short lived. Movements of Mexican sugar to the USA have been up and down, due to variations in the US import quota, Mexican internal supply and demand, and due to fluctuations in the world market, which at times has been a better destination for Mexican exports. Traditionally, Mexican exporters have had a difficult time getting hold of their share of the quota allocation when it has been needed the most. Even when the quotas have been substantial, internal arguing over allocations has delayed the distribution of the CQE's until late in the quota and crop year. These delays cost the exporters greatly for interest expense and lower sales prices due to shipments rushed late in the quota year.

Until 2006, shipments of over quota sugars to the US had been small and sporadic. In 2006 the floodgates opened and many users in the USA were thankful that Mexico had the stocks available. The weather events of the last few years forced some US consumers to take a risk and use Mexican sugar. In our experience the results were favorable, although we did hear of some customers (not ours) who had quality issues.



During the NAFTA transition period the import tax on over quota sugar has been reduced each year. When a surplus existed, Mexican exporters would compare the returns from sales to the US with the high tier tax, against sales to the World market, with a bias to the World market to avoid dumping suits in the US. Now that the import tax on Mexican sugar is insignificant, the World market price will have little to do with the decision as to where to export or at what price.

There still exists a large gap in the area of food safety and quality. US buyers have been able to dictate the terms for quality and procedures to the US domestic producers for decades. The standards have gotten extremely tight, even when many users could live with something other than Extra Fine Granulated (EFG). Although some Mexican refineries do meet US quality control standards for the most part, screening for grain size, metal extraction and detection, or lot control are simply not the norm for refineries in Mexico. The progress of quality control and efficiency in the sugar industry was stunted during the long period of time when the government held a monopoly of the sugar industry in Mexico. In Mexico until the early 1990's, there was only one supplier. If the users didn't like the quality, they had no other option. Even when the industry was sold back to the private sector, instability in the market certainly slowed investment at most mills and refineries. This gap will eventually narrow as Mexican suppliers will have to conform to USA industry standards in order to place any serious quantity across the border. Cross pollination between the US and Mexican industry will speed the leveling of the playing field. One would have to expect an increased level of cross border investment by refiners and processors once the post January 1 2008 rules are clear and implemented. At the same time, US users will most likely open up to alternative qualities, trading off lower price for higher color, variable grain size, etc… For many users, saving 1- 2 cents per pound for taking higher color and or non-screened sugar will be hard to pass up. The large imports from Mexico in FY 2006 opened the eyes of many industrial users to potential savings from buying something other than EFG.

The differences between US and Mexican production and distribution are significant.

In the US:

Beet sugar processors have built a large bulk storage capacity which enables them to deliver bulk sugar to their customers all year, without having quality issues due to repackaging.

Cane Refineries are located on the coasts with direct water access, allowing them to receive raw sugar all year, reducing the need to build a large storage capacity.

In order for a large scale integration of the two markets, US suppliers will have to deal with repackaging of bulk sugars to 50 kg bags, or build an extensive network of transfer stations for bulk sugar. In time the potential Mexican customers might consider installing bulk handling systems.

In Mexico:

Cane Mills and Refineries are located where the cane is grown. The entire production is accomplished during the harvest, which at best lasts 4-6 months. Storage of the finished product is in 50 KG poly bags, which are well suited for stacking in warehouses, and delivery to Mexican customers.

In order for Mexican sugar to compete in the US market on a regular basis, large bulk storage capacity would have to be built, to avoid repackaging. The alternative would be focusing on retail packaging, and passing on bulk delivery to US industrial customers.

The large investments that are needed in the Mexican mills and refineries to upgrade them to meet USA quality standards will only happen when the rules are clearly known. Although the NAFTA text is clear about an open border as of January 2008, it is hard to believe that the NAFTA sugar agreement will hold up when US farmers face a reduction in marketing allotments to compensate for potential imports from Mexico, or when blocked stocks from the US find their way to industrial users in Mexico City.

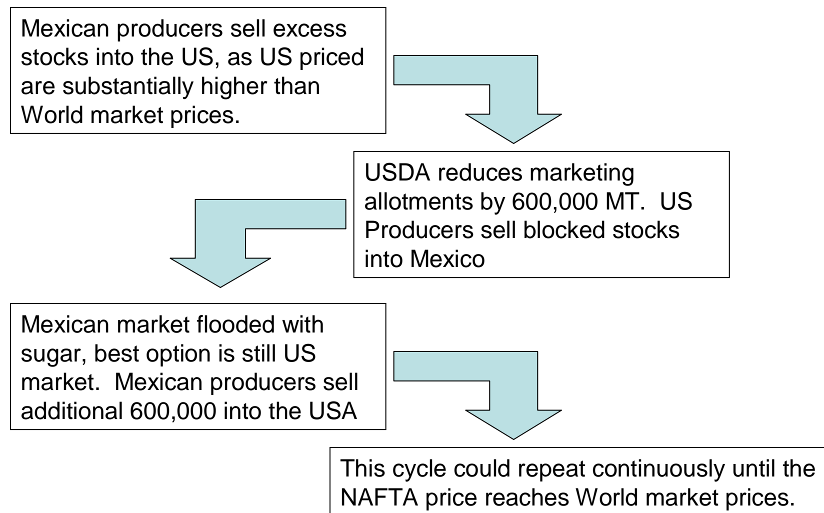
Mexico’s large swings in production will certainly add to the complexity of the setting of marketing allotments by the USDA. This year’s expected moderate to low Mexican production will let US producers get by without looking for protection from imports and reduced marketing allocations. However, one can easily imagine Mexico having a rebound in production next year, coming off of a year with high prices (sound familiar?). According to the current rules, Mexico has the right to export its surplus to the USA tax free as of Jan 1, 2008.

Will a large crop in the US, Mexico or both precipitate a price spiral to the bottom? I believe that the current rules have set the board for a potential disaster for producers on both sides of the border. A large crop on either side of the border or both will initiate the USDA in setting marketing allocations at a level where stocks will be blocked. Blocked US stocks will certainly head south, moving into Mexico without re-export credits.

Scenario:

Mexico production at 5.8 million MT, consumption at 5.2 million MT

US S&D balanced to heavy, marketing allotments restrict sales slightly.



Will the Mexican industry or government initiate a dumping suit, or countervailing duties? Without a common farm policy both markets face potential price declines as producers look for ways to move sugar away from their region. US producers have a lower cost structure and could probably wage an effective price war against Mexican producers if there is no negotiated solution. Would the Mexican government step back in and support the industry? With so many jobs at stake, I believe this is likely.

On top of un-coordinated farm policy, International trade agreements and tariff policy threaten the sugar industries in both countries. Imports into the US of finished or semi finished products with high sugar contents levels have soared over the last decade. These products include anything from bakery mixes to Mentos. The trend will certainly continue until all of the foods or candies that you buy will have come from some other country. Since most countries have a sugar re-export program or similar, and the US has low tariffs on finished foods and candies, the trend will continue until the price differential between the NAFTA market price for refined sugar is relatively close to the World market price for refined sugar.

Today, there are foods manufactured on the Mexican border, with either US re-export or PITEX sugar. These sugars are priced somewhere between the NAFTA and world market price. While it seems to some that these businesses should simply go away as of January 1, 2008, this would be the worst possible outcome. The products that are manufactured in these factories are the same ones that can be made in Brazil, Argentina or China. In most cases they can enter into the US tax free. The following table shows the approximate cost differentials for candy manufacturers by location.

	Non NAFTA	Mexico/NAFTA	USA
Refined Sugar Price	17.87	22.00	28.00
Labor Differential	(10.38)	(10.38)	0.00
Additional Freight	10.25	7.00	0.00
Tax @ 3%	0.54	-	0.00
Total	**18.28**	**18.62**	**28.00**

all in cents per lb. and based on sugar content.

all numbers are estimates.

Any change in the treatment of the movement of sugar to the Maquiladoras will only have the effect of moving manufacturing jobs out of both countries. Over time, this will move demand away from the NAFTA region and reduce the available homes for sugar. As long as high sugar content finished products can be imported into the USA with little or zero tariffs from non NAFTA countries, manufacturing of finished goods will continue to migrate to countries with lower cost structures. This obviously reduces the demand for refined sugar. So we not only lose the food manufacturing jobs, but the sugar industry jobs as well.

The bottom line is that farm, trade and tariff policy must be aligned to create a stable and equitable environment for growers, manufacturers and consumers. This is unlikely to happen in the foreseeable future.

And lastly, food for thought, or should I say Food for Fuel:

US OIL consumption for motor fuels in Barrels per day	13,000,000
10% ethanol target	1,300,000
Gals in BBL	42
Gals of ethanol per year target	19,929,000,000
Corn Ethanol availability (2012 estimate)	12,000,000,000
Deficit	7,929,000,000
Amount of sugar to make up deficit, in metric tons	50,351,991

USDA Agricultural Outlook Forum 2007

Transitioning into the Common Sweetener Market with Mexico

Paul Farmer

President, CSC Sugar LLC

Presented: Friday March 2, 2007

Why are the players not more prepared?

- Threats of Anti-Dumping suits have kept over quota shipments small until 2006.
- US buyers have difficulty handling 50 KG poly bags.
- Inconsistent supply has dampened interest.
- Delays in Mexican allocation of the Quotas internally have made marketing of their sugar very difficult, year after year.

SUGAR IMPORTS FROM MEXICO

M T

1,000,000
900,000
800,000
700,000
600,000
500,000
400,000
300,000
200,000
100,000
0

1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006

- Over-quota raw beet
- Over-quota raws
- Articles over 65%
- Over-quota refined, not specialty
- Over-quota refined, specialty
- Over-quota refined
- Articles over 10%
- Polyhydric
- Quota refined, not specialty
- Quota refined, specialty
- Quota refined
- Quota refined, colored
- Quota raws

Differences in Production and Distribution

USA

- Beet sugar processors have built large capacity of refined bulk storage.
- Cane refineries are located on the coasts, and are able to receive raw sugar all year.

Mexico

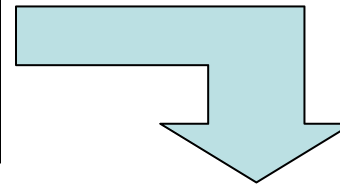
- Cane mills and refineries are all inland.
- Production is mostly limited to during the cane crushing season.
- Storage is in 50 kg poly bags.

Scenario:

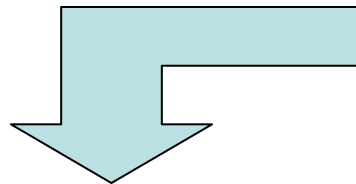
Mexico production at 5.8 million MT, consumption at 5.2 million MT.

US S&D balanced to heavy, marketing allotments restrict sales slightly.

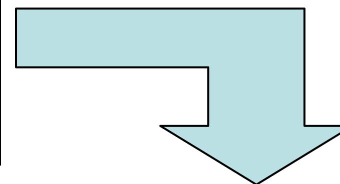
Mexican producers sell excess stocks into the US, as US priced are substantially higher than World market prices.



USDA reduces marketing allotments by 600,000 MT. US Producers sell blocked stocks into Mexico.



Mexican market flooded with sugar, best option is still US market. Mexican producers sell additional 600,000 into the USA.



This cycle could repeat continuously until the NAFTA price reaches World market prices.

Lather, Rinse, Repeat…

Candy Cost Comparison

Cost differentials for producing candy outside of NAFTA region vs. inside.

	Non NAFTA	Mexico / NAFTA	USA
Refined Sugar Price	17.87	22.00	28.00
Labor Differential	(10.38)	(10.38)	0.00
Additional Freight	10.25	7.00	0.00
Tax @ 3%	0.54	-	0.00
Total	**18.28**	**18.62**	**28.00**
all in cents per lb. and based on sugar content.			
all numbers are estimates.			

Summary

- Suppliers on both sides are un-prepared.
- As long as Farm and Trade policy do not mesh, there will be a problem.
- NAFTA re-negotiations cannot be considered finished.
- NAFTA should not be used as a vehicle to force the export of manufacturing jobs from the NAFTA region.

Food for Fuel

US OIL consumption for motor fuels in Barrels per day	13,000,000
10% ethanol target	1,300,000
Gals in Barrel	42
Gals of ethanol per year target	19,929,000,000
Corn Ethanol availability (2012 estimate) in gals	12,000,000,000
Deficit in gals	7,929,000,000
Amount of sugar to make up deficit, in metric tons	50,351,991

- 2006/2007 world production of sugar is estimated at 152.7 million MT
- It takes 14 lbs of sugar to make a gallon of alcohol.