Agricultural Regulations and Trade Barriers

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June 2009

Overview

The U.S. Department of Agriculture imposes extensive regulatory controls on agricultural markets. Some regulations are intended to promote safety and reduce disease, while others restrict commodity supplies and raise consumer prices. The Code of Federal Regulations includes 10,720 pages of rules for the USDA to enforce, covering everything from popcorn promotion to farmers' markets.[1]

Consider federal "marketing orders," which are used for milk, fruits, vegetables, and other products. The USDA says that these regulations are for "enforcing product quality standards, regulating the flow of product to the market, standardizing packages and containers, creating reserve pools for storable commodities, and authorizing production and marketing research and advertising."[2] Marketing orders are also designed to "improve returns to producers," according to the USDA.[3] Unfortunately, those government-generated profits usually come at the expense of American consumers.

Import barriers are another set of rules that confer benefits on certain farm producers at the expense of consumers. The Harmonized Tariff Schedule of the United States includes 364 pages of tariff listings for agricultural imports.[4] The general rate on turkeys is 6.4 percent, the rate on clam juice is 8.5 percent, and the rate on canned tuna is 35 percent. There are also substantial import barriers on milk, cheese, sugar, peanuts, cotton, orange juice, and rice. By raising prices, trade barriers harm consumers and damage American industries that use the protected products. They also work counter to USDA food programs that aid poor families, such as the food stamp program.

The following sections focus on the dairy and sugar industries, which are two of the most regulated agricultural markets, and two areas ripe for reforms.

Dairy Programs

The federal government has subsidized and regulated the dairy industry since the 1930s. Federal marketing orders for milk began in 1937. A dairy price-support program was added in 1949, and an income-support program was added in 2002. In recent years, dairy subsidies have cost taxpayers anywhere from zero to $2.5 billion annually depending on market conditions.[5] In addition, dairy programs stifle dairy industry innovation and raise milk prices for consumers.

The following are five ways through which the federal government intervenes in dairy markets:

1. Marketing Orders. The Federal Milk Marketing Order system sets minimum domestic prices for milk products. Two-thirds of the milk produced in the United States is sold under federal marketing orders.[6] Most of the rest is produced under similar state schemes, such as California's.

The federal system is structured around four classes of milk product: fluid milk, ice cream and yogurt, cheese, and butter and dry milk. On the basis of various formulas, the USDA sets separate regional prices for fluid milk and one nationwide price for each of the other three types of dairy product. Processors are required to pay farmers the same price whichever consumer product their fluid milk ends up in.

Marketing orders operate like cartels to limit competition. Entrepreneurs are not allowed to work outside the marketing order system and provide milk to consumers for less than the government-imposed prices. The current system also prevents lower-cost milk from more efficient producing regions, such as the Midwest, from gaining market share in higher-cost regions of the country, such as the Northeast.

2. Price Support Program. The Milk Price Support Program keeps market prices artificially high by guaranteeing that the government will purchase any amount of cheese, butter, and nonfat dry milk from processors at a set minimum price. These guaranteed purchases of storable dairy products create a steady demand and high prices for the products of all dairy farmers. Note that this program tries to prop up dairy prices at the same time that the income support program pushes them down.

3. Income Support Program. The Milk Income Loss Contract program, which was enacted in 2002, provides monthly payments to milk producers when market prices fall below target levels. This program encourages overproduction, which puts downward pressure on prices. The 1996 farm law was supposed to reduce dairy subsidies, but instead, dairy subsidies increased because of a series of supplemental subsidy bills passed in the late 1990s. Those supplemental "market loss" subsidies ultimately morphed into the more permanent MILC program in 2002.

4. Trade Barriers. Imports of dairy products to the United States are limited by "tariff rate quotas," which are complex tariffs that vary by product and import volume. From the government's perspective, trade barriers are a logical complement to dairy price supports and marketing orders, which are intended to keep domestic prices artificially high. Without import barriers, U.S. consumers could simply purchase lower-priced foreign dairy products. Thus, to reform dairy markets, both domestic controls and import barriers need to be removed.

5. Export Subsidies. The Dairy Export Incentive program was introduced in 1985 to provide cash subsidies to U.S. dairy producers who sell in foreign markets. Because U.S. dairy policies keep domestic prices above world prices, producers would otherwise have little interest in selling abroad. Thus, the rationale for dairy export subsidies is that they compensate for disincentives caused by other dairy programs.

Is there is any need for all these federal dairy programs? The USDA says that the purpose of marketing orders is to "promote orderly milk marketing relationships to ensure adequate supplies of milk and dairy products to meet consumers' demands at reasonable prices."[7] But it is very unlikely that dairy products need subsidies and regulations to fulfill those goals. After all, the free market price system achieves "adequate supplies" at "reasonable prices" without government help for thousands of other products such as clothing, electronics, books, and furniture.

In fact, the regulated dairy system does not deliver "reasonable" prices. Because of the controls placed on the dairy industry, milk prices are substantially higher than they would be otherwise, which penalizes millions of American families. The Organization for Economic Cooperation and Development found that U.S. dairy policies push up the price of milk to consumers by about 26 percent.[8] The U.S. International Trade Commission found that federal dairy policies push up the U.S. price of dry milk by 23 percent, the price of cheese by 37 percent, and the price of butter by more than 100 percent above world prices.[9]

The bottom line is that U.S. dairy programs unfairly transfer wealth from U.S. consumers to certain dairy businesses. Artificially high dairy prices also hurt downstream producers in the U.S. food industry that use dairy products as inputs to production.

U.S. dairy policies also harm trade relations with other countries. This can be seen most clearly in the failure of the Doha Round of trade talks. American protectionist policies in agriculture are an important factor that has inhibited the liberalization of trade in other sectors, which is to the detriment of American producers looking to expand export sales and to American consumers, who would benefit from lower prices due to trade liberalization.

The absurdity of federal dairy controls was driven home in a *Washington Post* profile of a maverick dairy entrepreneur in 2006.[10] Hein Hettinga, a Dutch immigrant, began a modest dairy farm and milk bottling plant in Arizona in the 1990s outside of the government system. He sold his milk to Arizona chain stores and to Costco in California at 20 cents less per gallon than the government-regulated milk. His low prices created a large demand for his products, and his business expanded rapidly. Costco executives believed that consumers were being "gouged" by the government-regulated system, and they were happy to provide customers with the new discount milk.

However, the producers in the government system were not happy with the competition from Hettinga. They began to vigorously lobby Congress to intervene, and a behind-the-scenes political battle ensued, which cost more than $5 million in fees to Washington lobbyists. Both Republicans and Democrats sought to protect existing producers in their states, and they teamed up to crush Hettinga and close the legal channel through which he was operating.[11]

Based on his experience, Hettinga said: "I had an awakening . . . it's not totally free enterprise in the United States."[12] That's particularly true in agriculture where innovation and Costco-style low prices are not allowed.

Sugar Programs

The federal government operates a complex system of supply controls, price supports, and trade restrictions on sugar. Sugar policies allow some farmers to reap large benefits at the expense of consumers and American businesses that use sugar in production. U.S. sugarcane production is located mainly in Florida and Louisiana. U.S. sugar beet production is mainly in Minnesota, Idaho, North Dakota, Michigan, and California.

Federal intervention in the sugar industry has a long history. The United States imposed tariffs on sugar imports in 1789 and has protected domestic sugar producers more or less ever since.[13] Congress imposed the first major controls on the domestic sugar market with the Jones-Costigan Act of 1934, which established quotas on production of cane and beet sugar. The Agriculture and Food Act of 1981 established the general structure of today's sugar price support system. The 2008 farm bill added a new sugar-to-ethanol program under which the government buys excess imported sugar that might put downward pressure on inflated domestic sugar prices. The program defends domestic sugar growers' 85 percent of the U.S. sugar market, and it provides for the government to sell excess sugar, at a loss if need be, to ethanol producers.

The federal government guarantees a minimum price for sugar in the domestic market by maintaining a system of preferential loan agreements, domestic marketing quotas, and import barriers. These policies impose a burden on consumers through higher prices. In recent years, USDA data show that U.S. sugar prices have been more than twice world market prices.[14]

There are three basic components of the federal sugar program:

1. Price Supports. To set artificially high sugar prices, the USDA operates a complex loan system. The agency makes loans to sugar processors, with processors using their sugar as collateral. In return, processors agree to pay sugar growers minimum prices set by the USDA. If the market price of sugar rises, processors sell their product on the market and pay back the loan. If the market price of sugar falls, processors are allowed to forfeit their collateral sugar to the government and not repay the loan. Alternately, they can repay their loan at a reduced rate. Either way, the effect is to guarantee minimum prices to processors and growers based on the loan rates set by the government. In addition, the federal government occasionally pays producers to discard their inventory to reduce "oversupply" on the market.

2. Trade Restrictions. Import barriers help maintain artificially high domestic sugar prices. The government applies a two-tier system of tariff rate quotas to limit imports. A lower tariff, the "in-quota" tariff, is for imports within a set quota volume. A higher tariff, the "over-quota" tariff, applies to imports in excess of the quota.[15] Federal officials allocate portions of the in-quota amount to 40 foreign countries. The system prevents lower-cost foreign sugar from putting downward pressure on domestic sugar prices. U.S. sugar imports are set at a very low level. Prior to the 1980s, imports accounted for almost half of the U.S. market, but today they have been restricted to less than 15 percent of the market.[16]

3. Domestic Quotas. The federal government not only controls sugar imports, it imposes detailed quotas, or "marketing allotments," on U.S. production. The USDA first guesses how much sugar Americans will consume in a year, then it decides what total U.S. production ought to be and allots 54.35 percent of production to beet sugar and 45.65 percent to cane sugar. The USDA then allots each U.S. state a specific amount based on a complicated formula. Like the dairy industry, the sugar industry is operated in a Soviet Union style with detailed central planning from Washington.

The big losers from federal sugar programs are U.S. consumers. The Government Accountability Office estimates that U.S. sugar policies cost American consumers about $1.9 billion annually.[17] At the same time, sugar policies have allowed a small group of sugar growers to become wealthy because supply restrictions have given them monopoly power. The GAO found that 42 percent of all sugar subsidies go to just 1 percent of sugar growers.[18] To protect their monopolies, many sugar growers, such as the Fanjul family of Florida, have become influential campaign supporters of many key members of Congress.

U.S. food industries that buy sugar are harmed by current sugar policies as well. The employment in U.S. sugar growing is 61,000, which compares to employment in U.S. businesses that use sugar of 988,000.[19] Thus, one small industry benefits from current sugar regulations, while industries that are more than 10 times larger are damaged. Many U.S. cane sugar refineries have been closed in recent years as the cost of raw sugar has been kept artificially high.

The U.S. Department of Commerce released a damning report on the economic effects of U.S. sugar policies in 2006. The report had five key findings:[20]

- U.S. employment in industries that use sugar, such as confectionery manufacturing, is declining.
- For each sugar growing and harvesting job saved through high U.S. sugar prices, nearly three confectionery manufacturing jobs are lost.
- Sugar costs are a major reason U.S. sugar-using companies have relocated their factories abroad.
- Numerous U.S. food manufacturers have relocated to Canada where sugar prices are less than half of U.S. prices and to Mexico where prices are two-thirds of U.S. levels.
- Imports of food products that use sugar as an input are growing rapidly.

U.S. candy companies have been severely affected by U.S. regulations that keep sugar prices high.[21] Chicago, the nation's candy manufacturing capital, has been hit hard, with many companies moving production abroad.[22] In 2002 Kraft moved its 600-worker LifeSavers factory from Michigan to Canada, where sugar is half the price.[23] Sugar prices also played a role in candymakers Brach's and Fannie May moving some operations out of the United States.[24] Hershey Foods closed plants in Pennsylvania, Colorado, and California and relocated them to Canada.

As with other industries burdened with irrational regulations, there is a history of legal and illegal efforts to circumvent U.S. sugar controls.[25] A few years ago, one Michigan company figured out a way to import syrup from Canada that was "stuffed" with low-cost sugar, and then extracted the sugar for use in products such as candy and cereal.[26] A legal battle, led by members of Congress from sugar states, ensued over the imports.

Another problem is the environmental damage caused by U.S. sugar policies. Large areas of the Florida Everglades have been converted to cane sugar production because of artificially high sugar prices. These wetlands have been greatly damaged by land drainage, habitat destruction, and the phosphorous in fertilizers used by sugar farmers.[27]

With all the negative economic and environmental effects of U.S. sugar programs, why do they persist? Sugar policies are a classic example of the government conferring benefits on a favored few at the expense of average households. There are relatively few sugar producers in the United States, but they form a notoriously powerful lobbying interest in Washington.[28] One advantage they have is that their subsidies mainly take the form of import protection, and thus do not show up as a costly line item in the federal budget.

The evidence of the negative effects of U.S. sugar policies could not be more clear. A small group of protected sugar barons is receiving a sweet deal at the expense of average families and the U.S. food industry. U.S. sugar subsidies, quotas, and production controls should be repealed before any further damage is done.

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[1] The page count for the Code of Federal Regulations includes 8,601 pages for Title 7 (Agriculture), 1,685 pages for Title 9 (Animals and Animal Products), and 434 pages for Title 36, Parts 200-299 (Forest Service). The rules for popcorn promotion are at 7CFR1215, and the rules for farmers' markets are at 7CFR249. The CFR is available at www.gpoaccess.gov/cfr/index.html.

[2] The USDA provides information on marketing orders at www.ams.usda.gov/fv/moab.html. A list of current marketing orders is at www.ams.usda.gov/fv/moabmotab.htm.

[3] Department of Agriculture, Marketing Order Administration Branch, "Marketing Order Program for Fruits, Vegetables, and Specialty Crops," March 8, 2006.

[4] The schedule is available at United States International Trade Commission, "Tariff Information Center," www.usitc.gov/tata/hts/bychapter/index.htm. Agriculture includes chapters 1 to 24.

[5] Ralph Chite, "Dairy Policy Issues," Congressional Research Service, June 16, 2006.

[6] Ralph Chite, "Dairy Policy Issues," Congressional Research Service, June 16, 2006.

[7] James J. Miller and Don P. Blayney, "Dairy Backgrounder," USDA, Economic Research Service, July 2006.

[8] Research cited in Sallie James, "Milking the Customers: The High Cost of U.S. Dairy Subsidies," Cato Institute Trade Briefing Paper no. 24, November 9, 2006.

[9] U.S. International Trade Commission, "The Economic Effects of Significant U.S. Import Restraints: Fourth Update 2004," Investigation no. 332-325, June 2004, p. 25.

[10] Dan Morgan, Sarah Cohen, and Gilbert Gaul, "Dairy Industry Crushed Innovator Who Bested Price-Control System," *Washington Post*, December 10, 2006, p. A1. See also Ralph Chite, "Dairy Policy Issues," Congressional Research Service, June 16, 2006.

[11] See www.keepmilkpriceslow.org.

[12] Dan Morgan, Sarah Cohen, and Gilbert Gaul, "Dairy Industry Crushed Innovator Who Bested Price-Control System," *Washington Post*, December 10, 2006, p. A1.

[13] Jose Alvarez and Leo C. Polopolus, "The History of U.S. Sugar Protection," University of Florida Institute of Food and Agricultural Sciences, June 2002. Protections have been occasionally removed, as they were briefly during the 1970s.

[14] Department of Agriculture, Economic Briefing Room, "Sugar and Sweeteners: Data Tables," www.ers.usda.gov/briefing/sugar/data.htm. See also Government Accountability Office, "Sugar Program: Supporting Sugar Prices Has Increased Users' Costs While Benefiting Producers," GAO/RCED-00-126, June 2000.

[15] Department of Agriculture, Economic Briefing Room, "Sugar and Sweeteners," February 22, 2007, www.ers.usda.gov/Briefing/Sugar/Policy.htm.

[16] Remy Jurenas, "Sugar Policy Issues," Congressional Research Service, September 4, 2001, p. 2.

[17] Government Accountability Office, "Sugar Program: Supporting Sugar Prices Has Increased Users' Costs While Benefiting Producers," GAO/RCED-00-126, June 2000, p. 5.

[18] Government Accountability Office, "Sugar Program: Changing Domestic and International Conditions Require Program Changes" GAO/RCED-93-84, April 16, 1993.

[19] U.S. Department of Commerce, International Trade Administration, "Employment Changes in U.S. Food Manufacturing: The Impact of Sugar Prices," February 2006.

[20] U.S. Department of Commerce, International Trade Administration, "Employment Changes in U.S. Food Manufacturing: The Impact of Sugar Prices," February 2006.

[21] Michael Schroeder, "Sugar Growers Hold Up Push for Free Trade," *Wall Street Journal*, February 3, 2004.

[22] Kari Lydersen, "Chicago Is Home Sweet Home to Fewer Candy Factories," *Washington Post*, February 7, 2006, p. A3.

[23] Laurent Belsie, "Bitter Reality: Candy Less Likely to Be 'Made in US'," *Christian Science Monitor*, April 8, 2002.

[24] Paul Blustein, "A Bitter Pill for Sugar Beet Farmers," *Washington Post*, June 7, 2005, p. D1.

[25] James Bovard, "The Great Sugar Shaft," Future of Freedom Foundation, April 1998, p. 8.

[26] Aaron Schwabach, "How Free Trade Can Save the Everglades," *Georgetown International Environmental Law Review* 14, Winter 2001.

[27] Aaron Schwabach, "How Free Trade Can Save the Everglades," *Georgetown International Environmental Law Review* 14, Winter 2001.

[28] Center for Responsive Politics, "The Politics of Sugar," May 1995, www.opensecrets.org. See also www.soursubsidies.org.

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