

## **Sparks Companies, Inc.**

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The prospect of an expanding market for U.S. corn sweeteners triggered expansion of U.S. High Fructose Corn Syrup (HFCS) capacity in the mid-1990s. Sparks Companies, Inc. (SCI) estimates that utilization of HFCS production capacity declined from more than 95 percent in calendar 1994 to roughly 75 percent in calendar 1997. Although HFCS exports to Mexico accelerated during this time, shipments began to level off starting in 1997. Exports in 1999 were roughly 200,000 metric tonnes (mt), dry basis. Stagnating exports to Mexico were in response to dumping duties assessed on U.S. imports and an agreement between Mexico's sugar and beverage industry to curtail HFCS use.

Low capacity utilization and accompanying low HFCS prices were a bitter disappointment for U.S. corn refiners. One small corn refiner ceased operations. A farmer-owned refiner is now leased by one of the largest U.S. corn refiners, while another farmer-owned refiner is partially owned by the largest U.S. corn refiner. The three largest corn refiners control 67 percent of U.S. HFCS production capacity. Although domestic HFCS use has grown in the last five years, capacity utilization is still below 90 percent.

Of the roughly 1 million mt of sugar used by Mexico's beverage industry, 500,000 mt could be replaced quickly by HFCS if Mexico removed the dumping duties and bottlers ended their agreement with the sugar industry. Transportation and infrastructure issues make it unclear if and when the remaining 500,000 mt of sugar would be replaced. If U.S. HFCS exports grew by an additional 500,000 mt in 2000, U.S. HFCS capacity utilization would exceed 90 percent. When the HFCS dispute is resolved, we expect increased HFCS exports from the United States, tighter U.S. HFCS capacity utilization, and higher corn sweetener prices.

The U.S. government and the corn refining industry have pursued three avenues to bring an end to the HFCS dispute: a Section 301 investigation by the

U.S. Trade Representative (USTR), a NAFTA dispute settlement panel, and a WTO dispute settlement panel. The Section 301 investigation ended last May, but USTR did not take any immediate action against Mexico. The NAFTA panel should hold its hearing some time this spring. The WTO panel released a preliminary ruling in October and a final ruling in January.

The WTO panel found that Mexico's sugar industry had proper standing to request a dumping investigation. However, the panel also found that Mexico did not properly conduct its investigation to determine if the imports caused damage to Mexico's sugar industry. The panel recommended Mexico bring the dumping duties into compliance with WTO rules. Although the appeals process will take several months, the WTO report is a victory for U.S. corn refiners and should place additional pressure on Mexico to strike a deal with the United States on corn sweetener and sugar issues this summer or fall.

The U.S. sugar industry has prepared for NAFTA's critical "Year 7," which begins on October 1, 2000. Realizing the sugar import quota would be no lower than 1.2 million mt and that Mexico would receive a quota of 250,000 mt, U.S. cane sugar growers began to vertically integrate. The majority of Florida's cane sugar crop is now channeled to grower-owned cane sugar refineries. The U.S. industry realized that the initial implications of minimum GATT and NAFTA quotas would be weakness in the No. 14 raw sugar price. Although Mexico may ship either raw or refined sugar to fill its NAFTA quota, Mexican standard sugar generally does not meet U.S. industrial specifications. Some industrial users have found success in melting Mexican sugar for use in select products, but liquid sugar accounts for less than 10 percent of U.S. sugar use.

The No. 14 market has come under extreme pressure, and this trend should continue well into next year unless the U.S. government takes some drastic policy action. Nearby No. 14 futures declined from 23 cents in mid-1999 to a low of 16.5 cents in November 1999. Current prices are close to 16.75 cents, basis May futures. SCI's preliminary fundamentals for 2000/01 indicate the U.S. sugar surplus could reach 650,000 short tons, raw value. In recent years, USDA has targeted a stocks-to-use ratio of 15.5 percent, but the ratio will exceed 18 percent in 1999/00 and approach 22 percent in 2000/01. Low raw sugar prices have pulled down refined sugar prices, as an independent cane

refiner sought to gain market share and other refined beet sugar sellers marketed a record beet sugar crop. The No. 14 raw sugar price declined by more than 6 cents per pound in less than a year, but refined sugar prices have declined by only 5 cents per pound. Thus, refining margins have improved and are expected to continue to firm as long as the bulk of the imports from Mexico are in raw form. Widening refining margins should entice Mexico's sugar industry to modernize and improve the quality of their sugar.

Low raw and refined sugar prices in the U.S. are expected to trigger another round of consolidation within the industry. Three refined sugar sellers currently account for roughly 75 percent of capacity. One seller is offering its beet sugar factories to local growers and has threatened to close two factories in California. Further contraction is expected in Hawaii. Despite current low prices, recent improvements in productivity, poor returns for alternative crops, and the perennial nature of sugarcane production suggest that sugar production will not contract in 2000/01.

Sugar producers and processors are expected to unite in the next few months and pressure the Clinton Administration for aid. Two actions that would dramatically reduce the surplus without tax payer expense include blocking imports of stuffed molasses (a sugar syrup imported from Canada) and "creatively" setting the 2000/01 import quota. The U.S. government may come under pressure to count Mexico's import quota as part of the GATT minimum or deny the larger quota altogether if Mexico does not comply with the WTO panel's recommendations. Either approach may damage relations with U.S. trading partners. In choosing its negotiating strategy, Mexico must balance the tradeoff between the amount of access to the U.S. market and the level of U.S. prices.