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Sugar Shakedown: How Politicians Conspire with the Sugar Lobby to Defraud America's Families

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Abstract

The sugar program, a government-created cartel administered by the U.S. Department of Agriculture (USDA), costs consumers an estimated $3.5 billion annually and has reduced employment by more than 127,000 jobs since 1997. Through production and import controls, the USDA shifts the cost of the program in the form of higher prices to consumers, which also allows supporters in Congress to claim that the program costs nothing to the federal budget. Congress should reform or eliminate the sugar program and require the Congressional Budget Office to assess the real economic costs and benefits of all price-support programs.

Early in the 20th century, a way of life for most of America's farmers came to an end. Industrialization was reaching the countryside, dramatically increasing farm productivity and putting downward pressure on prices. Against that backdrop, dramatically declining exports after World War I and during the Great Depression pushed American farms into bankruptcy by the thousands, a tale grippingly told in John Steinbeck's *The Grapes of Wrath*.[1]

In 1932, amid warnings of imminent revolution in the countryside, Franklin D. Roosevelt was elected on a promise to protect "the right to farm." The following year, Congress passed the Agricultural Adjustment Act (AAA) as part of Roosevelt's New Deal. The act paid farmers to destroy crops and livestock and leave land idle, thus restricting agricultural output and raising prices. The Supreme Court of the United States initially struck down the AAA as exceeding Congress's power to regulate commerce "among the several states," but subsequent versions of the law were upheld and expanded its reach.

Key Points

- The sugar program is a classic government-created cartel that forces American families to pay higher prices to sugar processors for a smaller supply of sugar.
- The program effectively requires the USDA to keep the market price well above the minimum guaranteed price, pushing all of the costs off budget and imposing them on consumers and businesses directly.
- Yet this program costs American taxpayers at least $3.5 billion per year, hurts food makers through higher food costs, pushes food jobs overseas, and benefits only a small number of producers and processors while officially costing the taxpayer nothing.
- By hiding the program's costs off budget, Members of Congress avoid accountability.
- Expanding free trade under NAFTA and the WTO may soon make the sugar program and other intractable and abusive agricultural supports unsustainable, forcing the federal government to dismantle them.

This paper, in its entirety, can be found at **http://report.heritage.org/bg2929**

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The government-created cartel has been a mainstay of America's agricultural sector ever since. The latest farm bill,[2] which was passed in January 2014, is projected to cost taxpayers nearly $1 trillion in subsidies, including food stamps, but it will cost consumers—America's families—far more than that.

Among the farm bill's most egregiously wasteful items is the sugar program, under which the federal government guarantees a minimum price at which it will purchase processed sugar stocks. The government then imposes strict production controls to keep the market price well above the minimum so that the full costs of the program are passed on to American families. Cartels come in many shapes and sizes, but their common element is restriction of output to raise prices above competitive levels.

The sugar program is a classic government-created cartel, enforced by government coercion rather than by conspiracy among cartel members, that forces American families to pay higher prices for a smaller supply of sugar. According to a study by John Beghin and Amani Elobeid of Iowa State University, the sugar program costs consumers about $3.5 billion each year and has reduced employment by more than 127,000 jobs since 1997.[3]

Huge Subsidy, Hidden Costs

The sugar program constitutes a huge subsidy for sugar producers and processors. Because it is an indirect subsidy in the form of higher prices rather than direct payments, it is off-budget by design and thus largely immune from public criticism. Under current law, the Congressional Budget Office (CBO) looks only at government outlays when it "scores" a bill. For years, this has allowed proponents of the sugar program to claim that it costs the taxpayer nothing. The program is supposed to be administered at no cost to the taxpayer. In fact, in most years, the program cost nothing to the federal budget,[4] but hiding the cost of a subsidy is not the same as eliminating it. In the case of the sugar program, the costs are much higher because of the insidious way in which they are hidden.

According to John Beghin and Amani Elobeid, eliminating the sugar program would dramatically lower America's food bill, not just for sugar, but for all foods that contain sugar. Indeed, lowering the wholesale costs for makers of sugar-containing products would make these secondary producers globally competitive again, leading to an export boom for their products with positive consequences both at home and abroad.

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The 2014 farm bill renewed the sugar program for another five years, but several measures were proposed to scale back or repeal elements of the program. In previous years, such measures might not even have been brought up for a vote, but this year, these amendments were only narrowly defeated, signaling that opposition to the sugar program is strengthening.

On May 22, 2013, during floor debate on the Senate version of the farm bill, Senator Jeanne Shaheen (D–NH) filed an amendment (S. Amdt. 925) that would have scaled back the sugar program substantially. It would have lowered the minimum guaranteed price and required the U.S. Department of Agriculture (USDA) to manage production controls and import quotas in a way that achieved "reasonable prices" for consumers and businesses. The measure was defeated 45–54, with 25 Republicans and 20 Democrats voting in favor of reform. Not one Senator

1. Jason Henderson, Brent Gloy & Michael Boehlje, "Agriculture's Boom-Bust Cycles: Is This Time Different?," Federal Reserve Bank of Kansas City *Economic Review*, 4th Quarter 2011, http://www.kansascityfed.org/publicat/econrev/pdf/11q4hendersongloyboehlje.pdf (accessed June 26, 2014).
2. Agricultural Act of 2014, Pub. L. No. 113–79.
3. John Beghin and Amani Elobeid, "The Impact of U.S. Sugar Program Redux," Iowa State University, Center for Agricultural and Rural Development *Working Paper* 13-WP 538, May 2013, http://www.card.iastate.edu/publications/dbs/pdffiles/13wp538.pdf (accessed June 26, 2014).
4. In 2013, the program directly cost taxpayers millions of dollars as the government bought 272 million pounds of sugar and sold it at a loss to biofuel producers. Jim Spencer & Mike Hughlett, "Slumping Sugar Prices Cost U.S. Taxpayers $53.3 Million," *StarTribune* (Minneapolis), October 1, 2013, http://www.startribune.com/business/225862401.html (accessed June 26, 2014).

from the states with the heaviest dependence on the sugar program—Minnesota, Michigan, North Dakota, Idaho, Louisiana, and Florida—voted in favor of reforming it. A similar measure was defeated in the House of Representatives.

The sugar program is tantamount to a fraud on the public. Congress should repeal it and all similar programs at the earliest opportunity. In the meantime, it should require the CBO to include estimates of overall economic cost to the American public when it scores price support programs.[5] U.S. trade negotiators should aim to reduce import restrictions and price supports in the agriculture sector, which has lagged far behind industrial production in trade liberalization.

A Government-Created Cartel

The basic idea of the sugar program is the same as that of any cartel: to raise prices well above competitive levels by restricting output. Administered by the USDA, it guarantees a minimum price at which the department will buy from sugar processors if they cannot sell at higher price on the domestic market. The USDA then relies on production controls to keep the market price well above the minimum price. Import controls are relaxed to keep the price from going too high, and a sugar-to-ethanol program allows the government to dispose of excess sugar in a scheme that further distorts the energy market.

The price floor is established by a "nonrecourse" loan facility for sugar processors, through which the USDA offers to purchase sugar stocks at a set minimum price when the market price falls below that level. The loans are essentially a prepayment for sugar at a set minimum price, which the processor can elect to "sell" to the United States if the market price is lower than the USDA price. Once the processor decides to make a draw on the loan program, it can (a) sell the refined sugar on the market and repay the loan from the proceeds or (b) deliver the collateral sugar stock to the government and thereby satisfy the loan obligation. This scheme has the effect of guaranteeing the minimum government price to each sugar processor. It also offers processors a cheap source of financing—yet another hidden subsidy. As a result, regardless of how high the market price is, a significant fraction of each year's refined sugar is placed under loan.

The minimum price floor, however, is merely a fail-safe. The USDA is required to administer the program at no cost to the federal budget. It accomplishes this by keeping the market price well above the price at which it would need to buy large amounts of sugar by assigning allotments that specifically restrict the amount of sugar that each processer can process (or refine) each year. The USDA specifies the maximum allowable production for each of the country's sugar processing companies. By controlling the price at which the processors sell sugar to food companies and the public, the USDA elevates the price along the entire supply chain from sugar production to retail sales. The Cato Institute's Chris Edwards has rightly described this as Soviet-style central planning.[6]

Proponents of the sugar program highlight the fact that it costs the federal budget nothing, but as seen through the lens of political economy, that is the program's worst aspect. Because the USDA is effectively required to keep the market price well above the minimum guaranteed price, all of the costs are pushed off budget and imposed on consumers and businesses directly. Thus, the program's real costs are not only hidden from the taxpayers, but also increased to levels far higher than necessary to sustain the minimum cartel price. Processors and producers reap a windfall because the program is designed to hide the costs. Indeed, the program imposes yet another layer of cost: the "deadweight loss" associated with forced transfer schemes that rely on monopoly and cartel arrangements through which the consumer systematically loses more than the beneficiaries gain.[7]

5. Many government programs result in hidden transfers of economic wealth from some parts of the economy to others, often through government intervention that restricts output and raises prices. Examples range from the minimum wage to the farm programs. The full economic costs of such programs should be far more transparent than they are, because in these cases a CBO score of "zero" is highly misleading to the public.
6. Chris Edwards, "The Sugar Program Is Central Planning," Cato Institute, November 7, 2013, http://www.cato.org/blog/sugar-program-central-planning (accessed June 26, 2014).
7. Arnold C. Harberger, "Monopoly and Resource Allocation," *The American Economic Review*, Vol. 44, No. 2 (May 1954), http://people.bath.ac.uk/ecsjgs/Teaching/Industrial%20Organisation/Papers/Harberger%20(1954)-AER.pdf (accessed June 26, 2014).

At its root, the sugar program is a nefarious bargain. As long as Congress can escape accountability by hiding the costs from the public, it enables the USDA to conspire to give the sugar lobby a substantial bonus on top of the minimum support price. American taxpayers are forced to underwrite—to the tune of at least $3.5 billion per year—a program that hurts food makers, pushes food jobs overseas, and benefits only a small number of producers and processors while officially costing the taxpayer nothing according to the Congressional Budget Office.

The worst kind of monopoly or cartel is one that is created and sustained by the government.

How Government-Created Cartels Defraud America's Families

In 1890, Congress passed the Sherman Antitrust Act to prohibit monopolization, price-fixing cartels, and other restraints on trade. Congress understood that arrangements that restrict output and raise prices hurt working families and result in significant economic losses for society as a whole.

What Congress did not understand is that the harm to competition flowing from purely private conduct often pales in comparison to the harm caused by government-enabled conduct. For example, a price-fixing cartel injures the public in the short run by reducing output and raising prices, but this often cannot be sustained under normal competitive conditions because the cartel cannot enforce cartel discipline or prevent new competitors from entering the market. Prices well above cost create an irresistible incentive for competitors to offer a lower price and take market share while still making a handsome profit. In fact, it is precisely this business rivalry that tends to push prices down close to marginal cost in the competitive economy.

The most effective and durable anticompetitive monopoly or cartel typically is one that enjoys government support. From a cartel conspirators' point of view, government is the perfect co-conspirator. Only government can guarantee cartel discipline and prohibit the entry of new competitors. In fact, because only government can ensure that the cartel or monopoly arrangement trumps competition (rather than the other way around), it can be stated as a general rule that the worst kind of monopoly or cartel is one that is created and sustained by the government.

The Cartel Constitution of 1937

Despite the great potential of government-created cartels to injure the public, Congress and the federal courts combined during the first half of the 20th century to shield them from the operation of the antitrust laws. Since then, democracy in America has become a story of massive cartels created by the government for the benefit of special interests.

This deal required a profound change in the Constitution as it was understood and handed down for the first 150 years after ratification. The original Constitution severely limited the federal government's powers to tax and regulate. Consequently, taxation and regulation were generally the exclusive domain of governments at the state level, where both taxation and regulation were subject to interstate competition for increasingly mobile labor and capital. That interstate competition exerted downward pressure on taxation and regulation—and cartel formation—much as market forces exert downward pressure on prices. This arrangement of government powers has been called "competitive federalism."[8]

The labor and agriculture interests of the New Deal coalition needed to change this. They needed, as Professor Richard Epstein of New York University Law School has said, to make the country safe for cartels. They created a powerful political force for constitutional change, and change is what they got. The New Deal was, in its essence, a program of government cartelization within the agriculture and labor markets. President Roosevelt and Congress combined to pressure the Supreme Court to adopt constitutional interpretations that would allow this cartelization for the benefit of labor and agriculture, even if those interpretations were plainly contrary to the text and design of the Constitution.

The Taft–Hartley Act of 1947 modestly rolled back cartelization of the labor market, but the New Deal's "emergency" cartelization of the agriculture

8. Michael S. Greve, "The State of Our Federalism," speech at Boise State University, September 16, 2011, http://www.aei.org/files/2011/09/16/State-of-Federalism-Greve.pdf (accessed June 26, 2014).

market has persisted even as the labor cartel has been weakened. There is no analogue in agricultural markets to the employer resistance that has blunted the force of labor unions since the end of World War II.

As Epstein recounts in *How Progressives Rewrote the Constitution*, the general norm of the late 19th and early 20th centuries was that government interference with prices and production (usually under state law) was warranted only in industries "affected with the public interest."[9] Otherwise, the freedom of association championed in *Lochner v. New York* (1905) was the order of the day. Before the New Deal, this "public interest" dispensation generally applied only to industries that tended to produce "natural monopolies," such as networked industries (e.g., railways). After the New Deal, it was applied broadly to all sorts of industries in which perfectly competitive conditions obtained, such as the sale of milk.

In *Nebbia v. New York*, the Supreme Court examined a naked price-fixing cartel under a New York law that imposed a minimum price of nine cents per quart of milk. One hapless retailer sold milk at the regulated price but threw in a free loaf of bread, which brought the wrath of the state down on his head. Upholding the state law, the majority demonstrated a woefully misguided understanding of economics:

> If the lawmaking body concludes that an industry's practices make unrestricted competition an inadequate safeguard of the consumer's interests, produce waste harmful to the public, threaten ultimately to cut off the supply of a commodity needed by the public, or portend the destruction of the industry itself, then any appropriate statutes passed in an honest effort to correct those threats may not be set aside because the new regulations fix prices reasonably deemed by the legislature to be fair to those engaged in the industry and to the consuming public.[10]

It is hard to improve on the dissent of Justice James McReynolds: "To him with less than 9 cents, [the New York law] says: You cannot procure a quart of milk from the grocer although he is anxious to accept what you can pay and the demands of your household are urgent!"[11] A law intended to safeguard "the consumer's interests" and prevent "waste harmful to the public" had the principal effect of injuring the consumer's interests (and those of the retailers who served the consumer) and creating waste harmful to the public. Yet such was the economic ignorance of legislators and judges that the law remained in effect for years.

The cartelized agriculture sector provides an elegant laboratory demonstration of why government-created cartels are terrible. When legislators and regulators override market signals of consumer demand with their own invariably biased convictions of "fair price," they distort the incentives for production. The effects are either overproduction with prices below competitive levels or restricted output with prices well above competitive levels. The "exchange velocity" that would quickly reallocate comparatively unproductive resources to positions of greater value is slowed, leaving the whole society worse off.

Under the Constitution as originally ratified and understood before the New Deal, competition and freedom of exchange were the norm. Because the federal and state spheres of authority were exclusive—the federal government could regulate only things in interstate commerce ("among the several states"), while the states could regulate their internal commerce—most regulation was at the state level and subject to interstate competition. Individual state governments were free to form whatever cartels they liked if their own constitutions permitted it. But without being able to control the movement of goods and people across state boundaries, any state that adopted wide-ranging cartels risked losing in the "marketplace" of regulatory competition, in which states compete for each other's labor and capital by adopting attractive regulations. The mobility of capital and labor increased with economic development, increasing the penalty for overregulation and cartel formation in particular.

One of the most powerful common drivers of the Supreme Court's New Deal decisions was the

9. Richard A. Epstein, *How Progressives Rewrote the Constitution* (Washington, DC: Cato Institute, 2006), pp. 77–81.
10. 291 U.S. 502, 538 (1934) (citations omitted).
11. Id. at 557 (McReynolds, J., dissenting).

New Deal coalition's ability to expand the federal commerce power so that both the federal and state governments could create cartels for their special interests.

- *National Labor Relations Board v. Jones & Laughlin Steel* sanctioned a federally imposed system of collective bargaining in factories and shops across the nation.[12]

- *U.S. v. Darby* upheld national labor standards for the first time.[13]

- *U.S. v. Wrightwood Dairy* allowed the federal government to regulate intrastate sales of milk that competed with the interstate agricultural price-support cartels of the New Deal.[14]

- The final blow—the Supreme Court's last Commerce Clause decision for the next 50 years—was *Wickard v. Filburn*, which upheld the agricultural price-support cartel against a farmer who was producing grain for his own livestock's consumption in an effort to use vertical integration to evade the cartel restrictions.[15]

After this vast expansion in the reach of federal law, the question arose whether states were still allowed to serve their special interests by creating monopolies and cartels despite the antitrust laws, whose reach had expanded coterminously with the commerce power. The Supreme Court answered affirmatively in *Parker v. Brown*. *Parker* and subsequent case law confirmed that state-created cartels enjoy immunity from federal antitrust enforcement if they were established pursuant to clearly articulated provisions of state law and actively supervised by the state. The upshot was that California, which produces the vast majority of the country's raisins, can capture the gains from cartel formation from citizens of other states, who have negligible power inside California.

Thus was "competitive federalism" transformed into "cartel federalism." The states' incentive to regulate as little as necessary under the original Constitution was transformed into a structural incentive to regulate as much as possible under the cartel constitution of the New Deal, an evolution that Michael Greve traces in *The Upside-Down Constitution*.[16]

Government programs designed to raise prices by constricting supply (such as the sugar program, the minimum wage, and occupational licensing) always boil down to a prohibition on private transactions that otherwise would compete profitably against the cartel arrangement. This shields the cartel from public competition. Thus, the American government switched sides from protecting the public against cartels to protecting cartels against the public.

Proponents of the New Deal and their progressive progeny explicate this transformation by pointing to the needs of a modern, nationally integrated economy. In so doing, they negate one of the major advantages of the modern economy: the strong tendency of labor and capital mobility to undermine local cartels. Thus, in the name of modernity, the New Deal progressives made a great leap backward to the era of crown monopolies of England before the Glorious Revolution.

The economic consequences of this development were profound. The prohibition on public competition effectuates a forced transfer from consumer to producer by allowing sugar processors to charge more for less sugar. The program is also grossly regressive because any increase in food prices hits poor families hardest. With the deadweight loss from monopoly and cartel pricing, the sugar program costs the public significantly more than it benefits its beneficiaries—all so that Members of Congress can escape accountability for the costs of a subsidy that would be politically impossible if they were honestly reported.

How does a program with so few winners and so many losers persist? To paraphrase Milton Friedman, reforming such a program is in the general

12. 301 U.S. 1 (1937).
13. 312 U.S. 100 (1941).
14. 315 U.S. 110 (1942).
15. 317 U.S. 111 (1942).
16. Michael S. Greve, *The Upside-Down Constitution* (Cambridge, MA: Harvard University Press, 2012).

interest, but not in anybody's special interest. "Each of us is fundamentally more concerned with our role as a producer of one product," he once said, "than with our role as a consumer of 1001 products."[17] The sugar program persists for the simple reason that the benefits are concentrated in just a few hands, while the losses—although far greater—are so diffuse that the public is largely unaware of them.

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The Promise of Free Trade

While globalization has increasingly integrated the world economy on the basis of free trade, agriculture has lagged. The North American Free Trade Agreement (NAFTA) and World Trade Organization (WTO), however, have become important sources of domestic agriculture policy reform. Further trade liberalization could further free the U.S. domestic market from the distortions of government-created cartels such as the sugar program. Thus, free trade holds the promise of dismantling the New Deal's cartelization of the U.S. agricultural market, which paradoxically could help to heal a constitutional wound that has festered for 70 years.

Under the sugar program, the USDA manipulates import quotas to keep prices from rising too much. For example, when sugar production falls short of the allotments, the USDA increases the volume of imports to compensate, thereby providing a way to limit rising sugar prices in the face of looming scarcity. NAFTA, however, disrupts the whole arrangement because under its terms, Mexico can sell essentially as much as it wants in the U.S. market and is not subject to the allotments imposed on domestic producers under the sugar program. Thus, Mexican sugar processors can receive the cartel price without restricting their output.

In 2013, Mexico exported more sugar to the United States than all other export sources combined.[18] This surge has exerted strong downward pressure on prices. Eventually, the pressure of Mexican producers may lead American processors to ask for larger allotments, and perhaps to the end of production quotas generally, unless they find a way to restrict Mexican imports at the risk of violating NAFTA. Simultaneously, the USDA may be required to reduce those allotments to avoid buying a significant share of all sugar produced in the U.S. The combination of these pressures could doom the sugar program in short order.

Free trade negotiations thus offer significant avenues for dismantling many of the most intractable and abusive agricultural supports, such as the sugar program.

Dismantling the Government-Created Cartels

To begin dismantling the most abusive agricultural supports, Congress should:

- **Substantially reform** the sugar program or eliminate it altogether,
- **Require** the CBO to assess the economic costs and benefits of all price-support programs, and
- **Change** all programs that effectuate a forced transfer to a form of transparent subsidy.

In addition, the U.S. government should use WTO negotiations to eliminate U.S. import restrictions and other price supports.

Tearing Down the Walls

The 1920s were a difficult time for America's farmers. With the end of World War I and the arrival of mechanization in the countryside, world food production soared, putting relentless downward pressure on prices.[19] Then the Great Depression brought

17. Milton Friedman, quoted in Mario Loyola, "The Poison of Protectionism," *National Review*, December 9, 2013, http://www.nationalreview.com/corner/365877/poison-protectionism-mario-loyola (accessed July 8, 2014).
18. U.S. Department of Agriculture, Foreign Agricultural Service, Office of Global Analysis, "Sugar: World Markets and Trade," May 2014, http://apps.fas.usda.gov/psdonline/circulars/Sugar.pdf (accessed June 26, 2014).
19. Henderson et al., "Agriculture's Boom-Bust Cycles."

an epidemic of bank failures in which millions of families lost their life savings, and protectionist barriers sparked a trade war.

America learned the lesson that protectionism is bad in foreign trade, but it has not learned the lesson that protectionism is even worse in the domestic market, not the least because it turns government into a fount of special favors for the politically connected at the expense of everyone else.

It is to be hoped that Americans will soon realize that the costs of farm support schemes such as the sugar program greatly outweigh the benefits. Congress should systematically repeal such programs for everyone's good.

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