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United States General Accounting Office

Report to Congressional Requesters

GAO

June 1988

SUGAR PROGRAM

Issues Related to Imports of Sugar- Containing Products



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**Resources, Community, and
Economic Development Division**

B-230319

June 22, 1988

The Honorable Jerry Huckaby, Chairman
The Honorable Arlan Stangeland, Ranking Minority Member
Subcommittee on Cotton, Rice, and Sugar
Committee on Agriculture
House of Representatives

In response to your February 11, 1987, request and subsequent meetings, we reviewed certain aspects of the U.S. sugar program to determine whether circumventions of the sugar quota system were taking place. Specifically, you asked us to provide information on (1) the amount of sugar in sugar-containing product imports that displaces domestic sugar, (2) the increase in such sugar imports from 1982, when the current sugar import quota system was put in place, to 1986, (3) the amount of sugar in sugar-containing product imports that enters U.S. commerce from foreign trade zones (FTZ)¹ and through ports of entry, (4) whether the U.S. Customs Service's controls over sugar-containing product imports have been adequate to ensure compliance with Customs laws and regulations, and (5) administrative options available to the President to limit the importation of sugar-containing products.

In summary, we found the following:

- Because product recipes are proprietary and data on imported sugar-containing products are nonverifiable, a precise accounting for such products cannot be made. However, on the basis of views and information provided by government and industry experts, we estimate that in 1986 from 265,000 tons to 307,000 tons of sugar may have displaced domestic sugar by entering the United States in sugar-containing products under 46 tariff categories. This was in addition to just over 1.7 million tons of commodity (raw and refined) sugar that was imported under the 1986 commodity sugar program quota. Domestic U.S. sugar consumption in 1986 was slightly less than 8 million tons.
- The amount of sugar in products imported under the 46 tariff categories in 1986 was more than double that in 1982. For some individual products, the increases were much greater. For example, imports of bulk sweetened chocolate bars and certain gelatin mixes increased more than tenfold from 1982 to 1986. One reason for such increases is that the U.S. tariff schedules, which are complex, allow resourceful businesses to

¹FTZs are secured areas geographically inside the United States but legally outside customs territory where companies are authorized to bring in merchandise to be stored, distributed, mixed with other foreign and domestic merchandise, or used in manufacturing operations.

“tailor” sugar-containing products to fit under different tariff categories. Some categories are subject to quotas; others are not. Further, duties can also vary by tariff classification.

- Of the additional sugar that entered U.S. commerce in sugar-containing products in 1986, about 40,000 tons were in products blended in FTZs. The rest was in products imported through various ports of entry.
- At some FTZs Customs paperwork controls and enforcement efforts were not always sufficient to ensure compliance with Customs laws and regulations. The most serious problems involved one FTZ user that has since discontinued operations and is currently the focus of a Customs criminal investigation. Customs has taken some actions to correct the deficiencies.
- Options available to the President to limit the importation of sugar-containing products include (1) extending additional import restrictions, via import quotas or fees, to sugar-containing products under existing authority where such imports are judged to be materially interfering with the U.S. sugar program and (2) submitting legislative proposals to rewrite tariff schedule descriptions to close loopholes.

Information on the federal sugar program, issues related to the program, and details on our findings and the administrative options that could limit sugar-containing product imports are discussed in the following sections.

Federal Sugar Program

The current U.S. sugar program was established by the Food Security Act of 1985. It continues a trade policy initiated early in the 1900s in which the federal government protects domestic sugar production by limiting the quantity of foreign sugar available on the U.S. market. This policy is similar to those of other governments that insulate their domestic sugar producers from fluctuating conditions in the world market. The U.S. position in the current round of multilateral trade negotiations, however, calls for the elimination of all agricultural subsidies, including those for sugar. The U.S. sweeteners advisory group, which is made up of industry representatives, supports this position provided that other sugar-producing countries eliminate their protectionist policies. (See app. I for information on world and domestic sugar trends.)

Essentially, the U.S. sugar program has two components—a domestic price support system and an import quota system. The price support system operates through nonrecourse commodity loans to eligible processors, who use their cane and beet sugar as collateral. These loans provide a floor under the market price. The 1985 act mandates that the

program operate at no cost to the federal government and establishes the national average loan rate for cane sugar at not less than 18 cents a pound, raw value, for the 1986 through 1990 crops. The act also requires that sugar beets be supported at a "fair and reasonable" price in relation to the support price for sugarcane, which was 21.16 cents a pound, raw value, for the 1987 crop. The price of sugar on the world market, by comparison, averaged 6.6 cents a pound during the first 8 months of 1987.²

The second component, the commodity sugar import quota system, facilitates higher prices for domestic sugar by limiting the availability of foreign sugar on the U.S. market. The commodity sugar import quota under the current system, in place since 1982, decreased 75 percent from about 3 million tons in 1984 to slightly more than 750,000 tons in 1988, a reflection in part of sizeable increases in U.S. sugar production accompanied by decreased per capita consumption. The 1988 quota is allocated to 39 countries that supplied sugar to the United States between 1975 and 1981. Certain countries, including Cuba, South Africa, and Nicaragua, are barred from exporting sugar to the United States.

The President has authority to implement, in addition to the commodity quota, quotas for specific sugar-containing products if imports of the products are practically certain to interfere or are materially interfering with the U.S. sugar program.³ Since 1983 the President has implemented quotas on four sugar-containing product tariff items.

The primary federal agencies that administer the programs and activities involving commodity sugar and sugar-containing product imports are the U.S. Department of Agriculture's (USDA) Foreign Agricultural Service and Agricultural Stabilization and Conservation Service; the U.S. Department of Commerce's Foreign Trade Zones Board (FTZ Board); the U.S. Department of the Treasury's Customs Service; and the U.S. International Trade Commission. (See app. II for information on these agencies' sugar-related programs and activities.)

²Less than 20 percent of world sugar production is traded on the world market, a residual market that does not reflect private sugar agreements. As a result, the world price does not accurately reflect the sale of all sugar in the world. Although the accuracy of the world price as an indicator of world sugar prices is subject to controversy, a basic belief among analysts is that U.S. sugar prices tend to exceed the world price. Critics of the sugar program use the difference between the world price and the domestic price as a measure of how much less U.S. sugar purchasers might pay without the sugar program.

³Under section 22 of the Agricultural Adjustment Act of 1933, as amended (7 U.S.C. 624).

Sugar Program Controversies

The U.S. domestic sugar program is a topic of ongoing controversy. Proponents claim that the program benefits domestic sugar producers without imposing a financial burden on the federal government. They also contend that without the program, domestic sugar producers might grow other crops, such as wheat or corn, which are heavily subsidized and would thus increase overall government costs. In addition, the proponents believe that the European Community's policy of exporting sugar at subsidized prices—unlike the current U.S. policy of limiting imports—has depressed sugar prices globally, hurting sugar producers worldwide.

In contrast, critics claim that while the domestic sugar program may not cost the public in terms of taxes, it results in artificially high prices for U.S. consumers and domestic producers of sugar-containing products. Critics contend that the import quotas also harm the economies of lesser developed countries, several of which are strategically located, by limiting the ability of their sugar industries to export sugar and sugar-containing products to the United States. They also state that high U.S. sugar prices, relative to world sugar prices, encourage additional domestic production and provide a price incentive to circumvent the U.S. import quota with cheaper world-price sugar.

An additional issue facing U.S. sugar producers is the competition from corn sweeteners and noncaloric and low-calorie sweeteners. Because corn sweeteners can replace sugar in many products, domestic corn sweetener producers indirectly benefit from the U.S. sugar program. U.S. corn sweetener use surpassed cane and beet sugar use for the first time in 1985. Much of the displacement has been in soft drinks, where less costly high fructose corn syrup has almost totally displaced sugar. The sugar price support program has indirectly helped establish the corn syrup market share by holding sugar prices at nearly twice the cost of producing high fructose corn syrup. Further aiding the corn syrup manufacturers are the changes in the federal corn price support program enacted in 1985, which have lowered corn prices.

Noncaloric and low-calorie sweetener consumption has also increased significantly, especially since the introduction of aspartame in 1981. Consumption of noncaloric and low-calorie sweeteners, on a sugar sweetness equivalent basis,⁴ increased from 8.2 percent of total U.S. sweetener consumption in 1981 to 18.5 percent in 1986.

⁴The sugar sweetness equivalent assumes that aspartame is 200 times as sweet as sugar and saccharin is 300 times as sweet as sugar.

Authorized Inflows of Foreign Sugar

Foreign sugar is authorized to enter the United States in three ways— (1) through the commodity import quota, (2) as nonquota sugar imported under license for processing and subsequent reexport or for making polyhydric alcohol, a sweetener used in such products as toothpaste and dietetic foods, and (3) in sugar-containing products through ports of entry and FTZs. Our estimates of the amount of sugar that entered the United States through these legal and administrative avenues during calendar year 1986 are shown in table 1.

Table 1: Estimated Sugar Inflows, 1986

(Tons in Millions)	
Authorized inflow method	Amount
Commodity import quota	1.75
Nonquota sugar for reexport	0.52
Nonquota sugar for polyhydric alcohol production	0.03
Sugar-containing products in 46 import categories (range)	0.26 to 0.31
Total	2.56 to 2.61

Statistics on commodity sugar imports within the quota authority and on nonquota sugar for reexport or polyhydric alcohol production are relatively accurate. Statistics on the amount of sugar imported in sugar-containing products are inexact because industry formulas for those products are considered proprietary information, and the available data are not as credible as they are for commodity imports. However, on the basis of views and information provided by government and industry experts, we developed a list of sugar-containing products in 46 tariff categories, estimated the sugar content of the products, and computed the low and high inflow estimates shown in table 1. (See apps. III and IV for additional information on these estimates.)

Increase in Imports of Sugar-Containing Products From 1982 to 1986

Overall, the volume of sugar in the products in the 46 categories in 1986 was more than double that in 1982, when such products contained from 103,000 tons to 118,000 tons of sugar. The products with the sharpest increases included gelatin/sugar mixes and bulk-size sweetened chocolate bars, both of which had volume increases of over 1,000 percent from 1982 to 1986. Differences in product quotas and duties prescribed in the U.S. tariff schedules help explain the sharp increases. For example, although gelatin/sugar mixes frequently contain more than 90 percent sugar, they are eligible for a tariff category that is exempt from sugar quotas, and a lesser duty applies when the value of the gelatin is greater than the value of the sugar. Conversely, gelatin/sugar mixes not

meeting that criterion are placed in another tariff category for which a quota and higher duties have been established. From 1982 to 1986 gelatin/sugar mixes imported under the sugar quota-free category increased by 1,150 percent.

In the case of sweetened chocolate bars, those weighing 10 pounds or more are exempt from duties while those weighing less than 10 pounds are subject to a 5-percent duty. Imports of sweetened chocolate bars weighing 10 pounds or more increased nearly 1,345 percent from 1982 to 1986, compared with a 25-percent decrease in bars weighing less than 10 pounds.

Sugar in Products Imported From Foreign Trade Zones

Blended products produced in FTZs and imported in 1986 contained about 40,000 tons of sugar, or about 13 to 15 percent of the sugar volume we estimated for products in the 46 import categories. The purpose of FTZs is to expedite and encourage U.S. participation in international trade and commerce by providing a base of operations that would otherwise occur in other countries. Blended products produced in a zone may be exported without incurring U.S. duties or may be entered into U.S. customs territory subject to appropriate quotas and upon payment of applicable duties.

Sugar-blending operations were first approved for FTZs in September 1983 after USDA advised the FTZ Board that it would not oppose such operations. In August 1984 USDA advised the FTZ Board that it believed that approval should be withdrawn for FTZ operations that blended sugar for U.S. importation because such operations interfered with the domestic price support program. Because seven companies with ongoing or approved operations provided domestic employment and/or had already invested in equipment, and because the blending operations would otherwise occur in foreign countries, the FTZ Board gave the companies "grandfathered" approval for their operations in late 1984. At that time the FTZ Board set an annual limit of 55,950 tons of sugar in the products those firms produced for domestic consumption. According to the FTZ Board, five "grandfathered" companies carried out sugar-blending operations during 1986. Three were operating as of May 1988.

Controls Over Sugar Import Operations

Customs has extensive regulations and procedures designed to control imports. At the same time the U.S. tariff schedules allow resourceful businesses to "tailor" products to fit under specific duty and/or quota classifications. We found weaknesses in Customs controls at some FTZs

and ports of entry. Under certain circumstances, we found that Customs did not always enforce its regulations and procedures.

The following situations illustrate that resourceful businesses will do all that is possible within the bounds of the law, and that some businesses may try to go beyond the law, in order to benefit from cheaper world-price sugar. Because product recipes are proprietary, we were not able to provide a precise accounting of the amounts of sugar involved in these situations. However, we provide quantifiable data where available. After we discussed these situations with Customs, it took action to correct the weaknesses in paperwork controls and enforcement procedures.

Reclassification Can Legally Avoid Quotas of Sugar-Containing Product Import Categories

Our review showed that a manufacturer in one FTZ was able to reclassify, with Customs approval, its sugar-containing product to a nonquota tariff classification with a lower duty rate by adding a very small percentage of flavoring ingredient to the product when the product was in the FTZ. The flavoring was previously added after the product left the FTZ. Customs ruled that the flavored mix constituted a new and different product. The change was approved after the manufacturer threatened to move its FTZ operations to another country, thereby eliminating U.S. jobs.

Quantity of Sugar Entering Foreign Trade Zone Was Not Always Accounted For

Sugar entering the United States at ports of entry and destined for FTZs is sealed by Customs inspectors and transported to the zones under in-bond status. Technically, this means that the sugar is not imported into the United States until it is placed into domestic commerce in the form of sugar-containing products made in the FTZ. At the FTZ the seal is to be broken by a Customs employee or, with Customs authorization, by the FTZ operator (the entity that operates the zone).

During a visit to one FTZ, we noted that the seal on a 132-ton shipment of sugar had been broken by the user (the sugar-blending company) rather than by the FTZ operator and that the shipment was unloaded into the trade zone without the knowledge or approval of Customs district officials or the FTZ grantee. If the quantity of sugar shipped into the FTZ is not accounted for upon arrival in the zone, sugar could be diverted before it reaches the FTZ, or a greater amount of sugar could be received in the FTZ than shown on the shipping documents. Either case would allow the user to dispose of commodity sugar in U.S. commerce before

the sugar is charged against the applicable quota. In addition, contra-band could be sealed in the shipments. After we brought this matter to the attention of Customs district officials, the district notified the FTZ operator that the delivery practice was contrary to Customs regulations and that future shipments would require prior Customs approval. Customs issued a directive on May 31, 1988, reiterating its position to all regional offices. (See app. VIII.)

Unauthorized Sugar Has Been Diverted Into U.S. Commerce

In another case, a sugar-blending company had brought significant amounts of sugar into an FTZ in excess of FTZ Board-authorized amounts. Available documents showed that in an apparent attempt to circumvent its sugar quota, the company had blended the additional sugar with gelatin, exported the gelatin/sugar blend, brought a like amount of the same blend back into the zone (under a different company name), and then sold the blend to a U.S. food company. According to Customs regulations, shipping merchandise abroad with the intention of returning it to the United States to circumvent provisions of the tariff schedule (including sugar quotas) or to secure a benefit accruing to imported merchandise is not considered to be an exportation and therefore is not allowed.

We estimate that as much as 1,500 tons of foreign sugar was blended with gelatin, exported to Canada, repurchased and reimported, and then sold within U.S. commerce in 1986 in excess of the FTZ Board-authorized amount. By January 1988 the sugar-blending company had discontinued operations, and Customs had begun investigating it for possible criminal violations. As of May 1988 the matter was still under investigation, but Customs had already taken action to help prevent repetitions of this circumvention. A May 2, 1988, Customs ruling requires that such exportations be charged against the FTZ Board allocation in the same manner as when the products enter U.S. commerce. FTZ Board officials told us that the Board would not allow the company to resume operations pending the outcome of the Customs investigation.

Sugar-Blended Products May Have Originated in Country Subject to Import Restrictions

In at least one FTZ, some sugar had been received from Canada that had been grown in South Africa, which is subject to a U.S. embargo. The Comprehensive Anti-Apartheid Act of 1986 prohibits the U.S. entry of agricultural products, including sugar, from South Africa. The 1986 act also prohibits the U.S. import of derivatives of sanctioned products or any product suitable for human consumption. However, in November 1986 Customs approved the entry of 20 lots, or an estimated 440 tons,

of South African-grown, Canadian-refined sugar into one FTZ. Customs' position at the time was that sugar refined in Canada was substantially transformed and not subject to South African sanctions. Customs reversed its position in 1987. The May 31, 1988, directive further clarifies Customs' position that refining raw sugar does not substantially transform it nor change its country of origin. (App. V contains additional details on these and other examples involving controls over sugar import operations.)

Administrative Options for Limiting Sugar-Containing Product Imports

Customs has taken some actions to improve its administration of FTZ Board sugar allocations and other enforcement mandates of the U.S. sugar program. Monitoring the implementation of these improvement actions could help ensure the proper entry of sugar-containing products. Other options, which are available to the President to limit sugar-containing product imports, include the following:

- Extending import restrictions, via import quotas or fees, to additional sugar-containing products. Such an action should include a comprehensive analysis of all sugar-containing products that carefully describes the products to avoid creating new loopholes.
- Submitting a legislative proposal to rewrite tariff schedule descriptions so that existing loopholes can be closed while avoiding the creation of new loopholes.

(App. VI provides additional information on the administrative options.)

Agency Comments

We requested written comments from the Department of the Treasury, but none were provided in time for inclusion in the report. However, Customs officials told us that Customs recognized the validity, at the time of our review, of many of the problems and shortcomings of Customs' administration of the sugar program in FTZs. They also said that Customs had taken steps to correct the major problems. They said that a March 1988 on-site survey of Customs supervision procedures at FTZ sugar-blending operations had verified some of the weaknesses we had pointed out, as well as identified additional weaknesses. The Customs regions were given 60 days to report on their corrective actions. In addition, Customs has increased training of its officers in FTZ matters, and on May 31, 1988, it issued a servicewide directive incorporating all existing instructions into one document. (See app. VIII.) According to Customs, the training and directive should improve the quality of Customs' enforcement of its procedures and requirements.

The Departments of Agriculture and Commerce provided written comments on a draft of this report. Commerce commented that our report and the position of Customs on control issues will have an effect on whether and to what extent the FTZ Board allows the grandfathered sugar-blending operations to continue in FTZs. USDA's comments focused on the estimates of sugar in sugar-containing products, noting that USDA's estimates were higher because they reflected the amount of sugar and alternative sweeteners being imported in sugar-containing products irrespective of whether domestic production was being displaced. (See apps. IX and X.)

We made our review primarily from March through November 1987, with updates as appropriate through June 1988. We interviewed U.S. government officials administering the sugar program and reviewed legislation, regulations, and agency records on imports of commodity sugar and sugar-containing products. We visited FTZs and ports of entry where we reviewed records; observed operations, including implementation of Customs' controls; and interviewed both government and private parties involved with or affected by sugar imports. We also interviewed several government and private industry sugar experts to obtain their perspectives of sugar imports and to identify significant imported sugar-containing products and estimate the products' sugar content. (App. VII provides additional information on our objectives, scope, and methodology.)

We are sending copies of this report to the Director, Office of Management and Budget; the Secretaries of Agriculture, the Treasury, and Commerce; and other interested parties. Copies will be made available to others on request. Major contributors to this report are listed in appendix XI.

Sincerely yours,



Brian P. Crowley
Senior Associate Director

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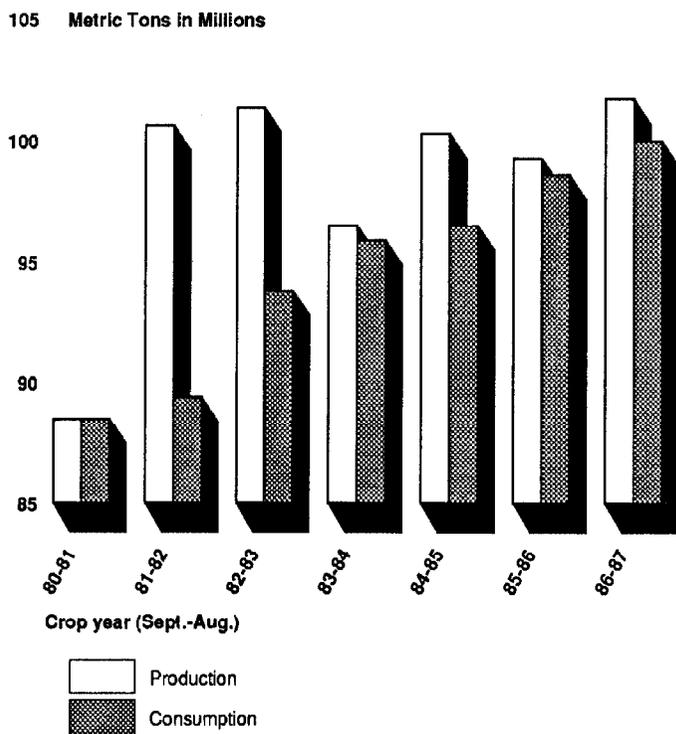
CCC	Commodity Credit Corporation
CF	Customs form
ERS	Economic Research Service
FAS	Foreign Agricultural Service
FTZ	foreign trade zone
GAO	General Accounting Office
HFCS	high fructose corn syrup
ITC	International Trade Commission
MSP	market stabilization price
TSUSA	Tariff Schedules of the United States Annotated
USDA	U.S. Department of Agriculture

Sugar Trends

This appendix provides information on world and domestic sugar production and consumption, sugar prices, corn sweetener consumption, and imports of sugar-containing products.

World Sugar Production and Consumption Has Increased in the 1980s

Figure I.1: World Sugar Production and Consumption, Crop Years 1980-81 Through 1986-87



Source: Sugar and Sweetener Situation and Outlook Report, Economic Research Service (ERS), U.S. Department of Agriculture (USDA), Sept. 1987.

World sugar production increased from 88.5 million metric tons in crop year 1980-81 to roughly 102 million metric tons by crop year 1986-87. World consumption rose from 88.5 million metric tons to over 100 million metric tons for the same years.

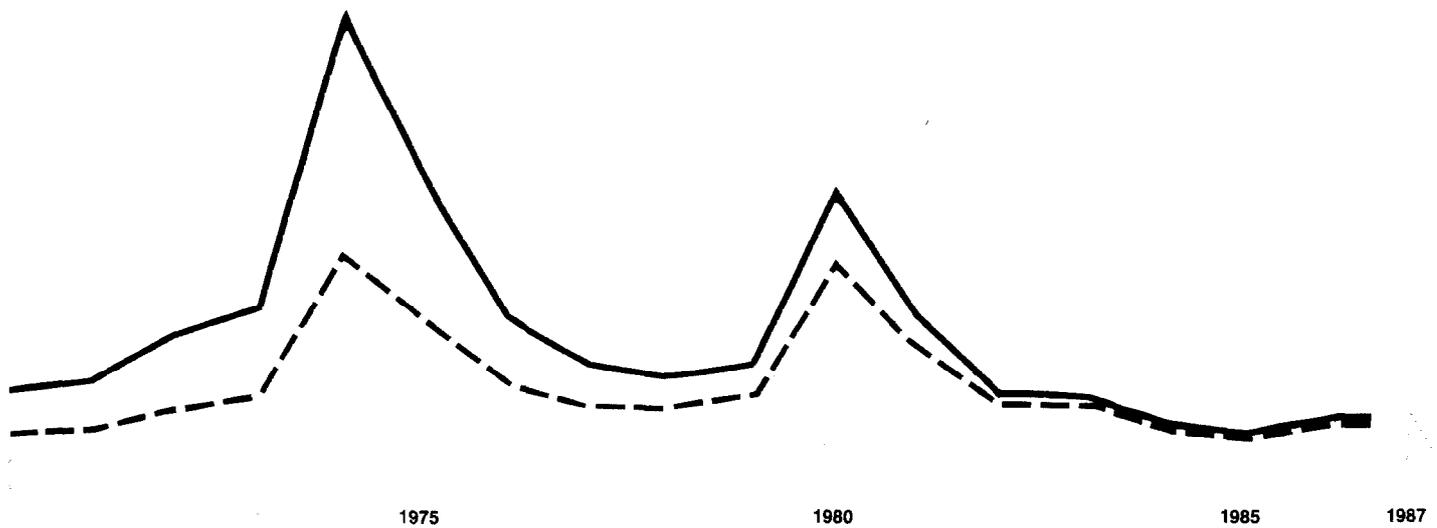
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Sugar Trends

World Sugar Prices Have Been Erratic Since the 1960s

Figure I.2: Average World Sugar Prices (raw value), 1952-87



Appendix I
Sugar Trends

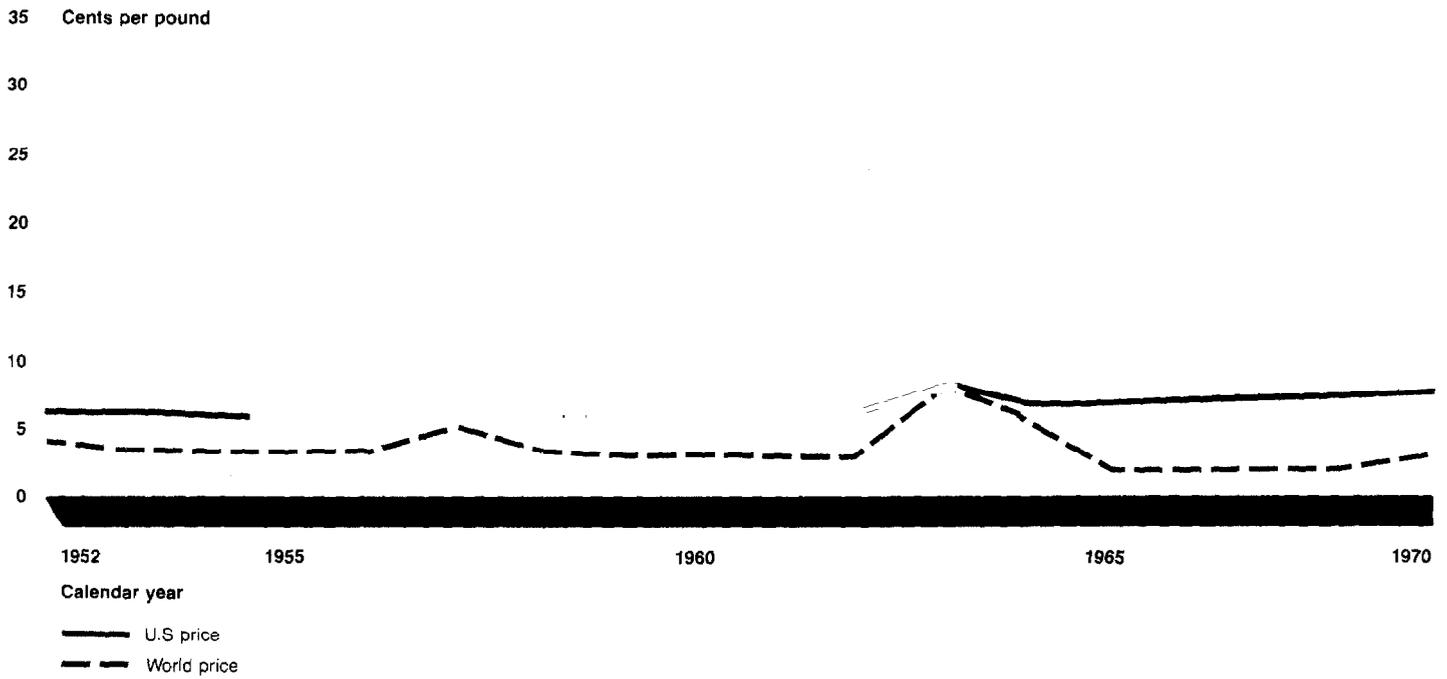


Source: ERS data based on Coffee, Sugar and Cocoa Exchange, Inc., information.

World sugar prices have been erratic at times since the early 1960s. The greatest single-year drop in the 1980s, a drop of 50 percent, occurred between 1981 and 1982. From 1980 through 1987 world sugar prices decreased by 77 percent. The average price during the 1980-87 period was 10.61 cents a pound.

U.S. Sugar Prices Exceed World Prices

Figure I.3: U.S. and World Average Sugar Prices (raw value), 1952-87



Appendix I
Sugar Trends

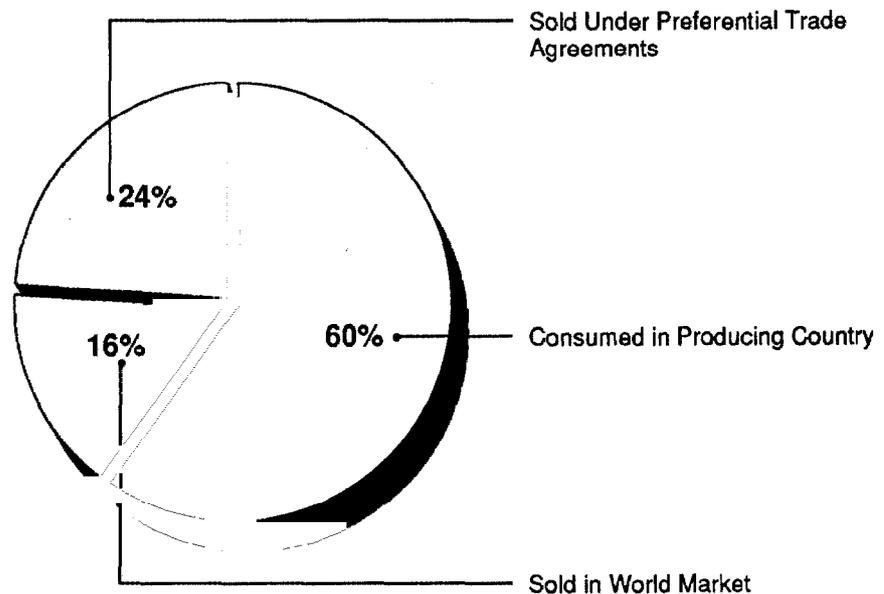


Source: ERS data based on Coffee, Sugar and Cocoa Exchange, Inc., information.

From 1952 through 1987 the U.S. price for raw sugar was almost always above the world price. In the 1980-87 period the U.S. price ranged from just above the world-price level in 1980 to over five times the world-price level in 1985.

Only a Small Share of World Sugar Production Is Sold in the World Market

Figure I.4: World Market Sugar Trade,
Crop Year 1986-87

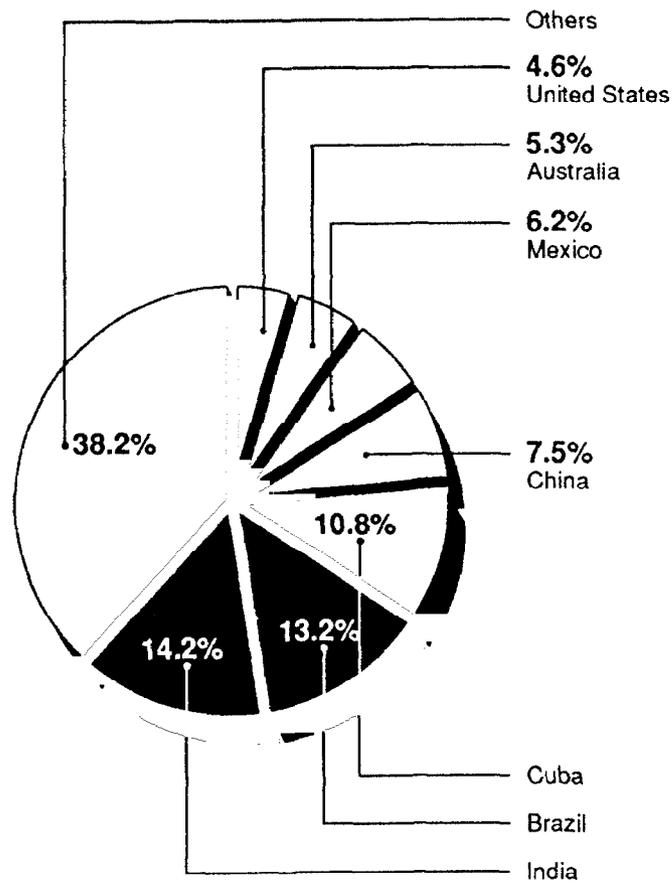


Source: J. Womach, *Sugar: Reexamining U.S. Policy*, Congressional Research Service, IB87141, reprinted in *Congressional Record*, Nov. 19, 1987.

In crop year 1986-87, 16 percent of world sugar production was traded on the world market, a residual market that does not reflect individual nations' pricing policies or preferential trade agreements. Sixty percent of world production was consumed in the country of origin. The remaining 24 percent was sold under preferential trade agreements.

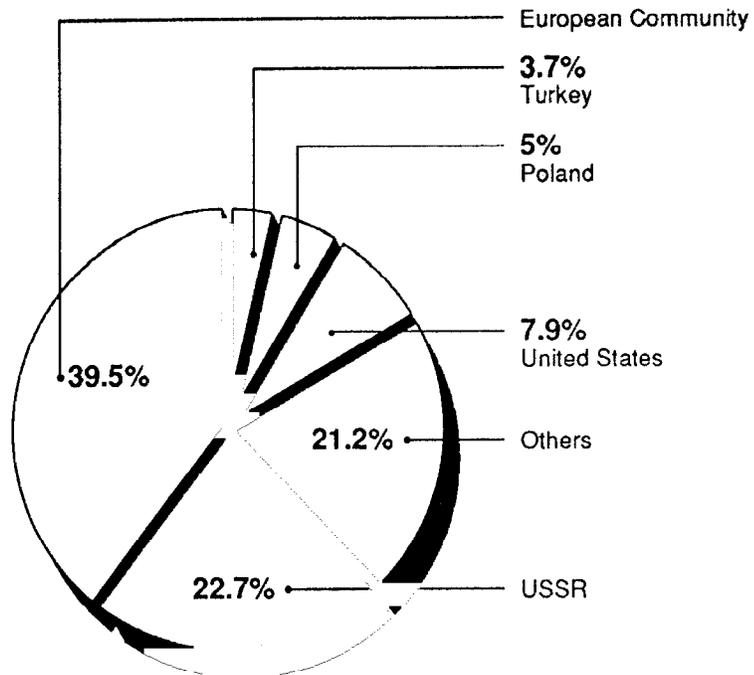
U.S. Sugar Production Is a Small Portion of World Production

Figure I.5: U.S. Share of World Cane
Sugar Production, Crop Year 1986-87



Source: F.O. Licht's International Sugar Report, Oct. 1987.

Figure I.6: U.S. Share of World Beet
Sugar Production, Crop Year 1986-87



Source: F.O. Licht's International Sugar Report, Oct. 1987.

In crop year 1986-87 the United States accounted for 4.6 percent of world cane sugar production and 7.9 percent of world beet sugar production.

While U.S. Production Has Increased in the 1980s, U.S. Consumption Has Decreased

Figure I.7: U.S. Sugar Production and Consumption (raw value), 1980-87



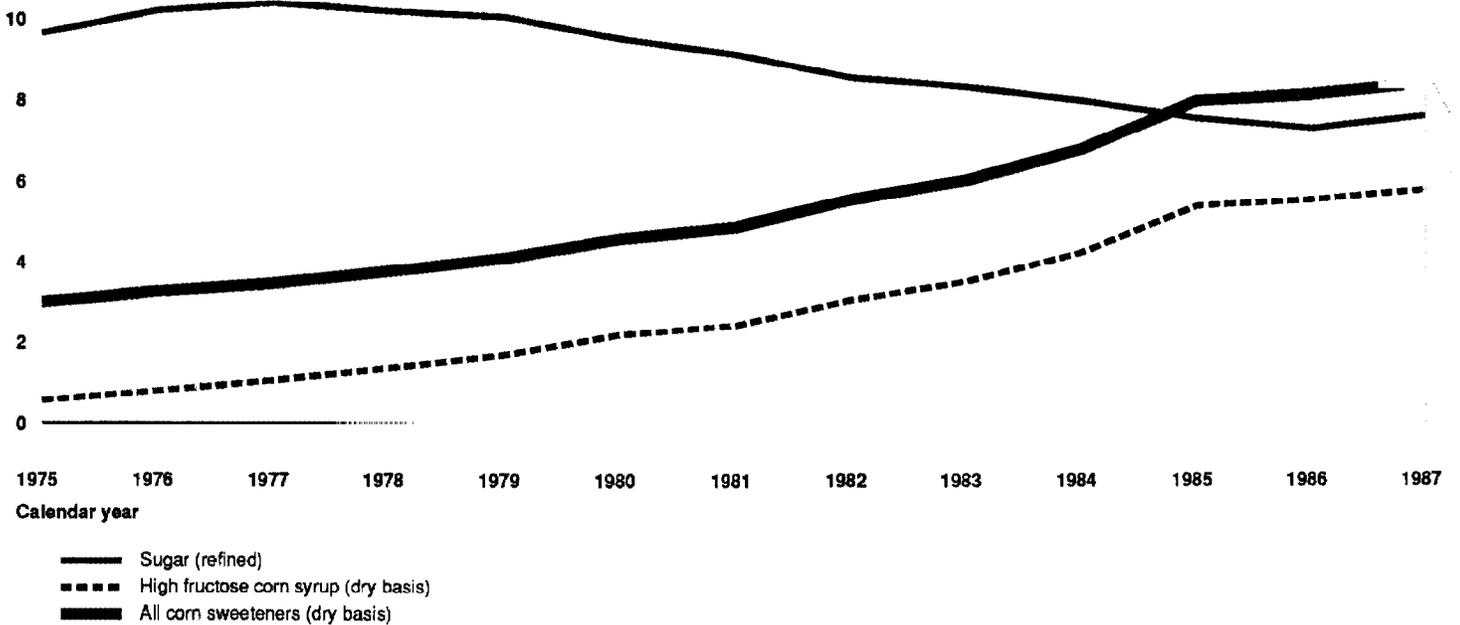
Source: Sugar and Sweetener Situation and Outlook Report, ERS, USDA, Sept. 1987, tables 11 and 29, and Mar. 1988, table 21.

Domestic sugar production increased from 5.7 million tons in 1980 to 6.3 million tons in 1986. U.S. beet sugar production increased nearly 5 percent, from about 3.05 million tons in 1980 to 3.20 million tons in 1986, and domestic sugarcane production increased by 14 percent, from 2.68 million tons in 1980 to 3.06 million tons in 1986. On the other hand, domestic sugar consumption declined by about 20 percent, from about 10 million tons in 1980 to slightly less than 8 million tons by 1986.

Corn Sweetener Consumption Has Surpassed Sugar Consumption

Figure I.8: U.S. Sugar and Corn Sweetener Consumption, 1975-87

12 Tons in Millions



Source: Sugar and Sweetener Situation and Outlook Report, ERS, USDA, Sept. 1987, table 29, and Mar. 1988, table 16.

Because corn sweeteners can be substituted for sugar in many products, domestic corn sweetener producers indirectly benefit from the U.S. sugar program. Corn sweetener use in the United States surpassed cane and beet sugar use for the first time in 1985. In terms of volume, 1987 consumption of all corn sweeteners, including high fructose corn syrup (HFCS), glucose, and dextrose, was estimated to reach 8.27 million tons, compared with 8.1 million tons for cane and beet sugar. Of the corn sweetener consumption, HFCS consumption was estimated at 5.65 million tons.

Some Sugar-Containing Product Imports Have Increased

Table I.1: Sugar-Containing Product Categories With Greatest Import Increases Between 1982 and 1986

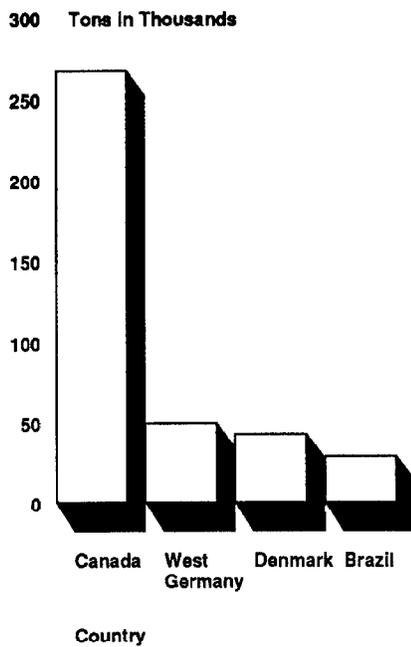
(Tons)				
Tariff category	Description of imports	Imports		Percentage increase
		1982	1986	
156.25	Bulk sweetened chocolate bars	2,108.40	30,463.21	1,345
182.90	Edible preparations of gelatin	2,016.40	25,166.29	1,148
153.03	Currant and strawberry jelly	447.68	5,573.28	1,145
154.05	Candied cherries	87.25	898.18	929
153.24	Pineapple jelly	8.65	66.15	665

Source: Developed from Bureau of the Census data.

Domestic manufacturers of food products, such as candy, confections, and bakery goods, generally oppose the restrictions of the domestic sugar program because such users are deprived of currently cheaper, world-price sugar. High domestic prices for sugar, a main ingredient for their products, place domestic sugar users at a competitive disadvantage against imports of finished sugar-containing products and other competitive domestic products that do not require sugar. Although import restrictions have been imposed on certain sugar-containing products, imports in many of the categories have increased substantially.

Foreign Manufacturers Export More to the United States

Figure I.9: Countries Exporting Greatest
Quantities of Sugar-Containing Products
to the United States in 1986



Source: Developed from Bureau of the Census data.

Just as domestic manufacturers of sugar-containing products are placed at a competitive disadvantage because of higher domestic sugar prices, foreign competitors have a competitive advantage when they have access to world-price sugar and can later export their products to the United States. These foreign competing products are generally sold at lower prices than their American counterparts. For example, Canadian manufacturers of sugar-containing products have access to world-price sugar. Canadian imports ranked the highest in 1986, representing about 40 percent of the over 660,000 tons of sugar-containing products imported into the United States. The countries with the next highest imports were West Germany, Denmark, and Brazil.

Federal Sugar Programs and Administration

The federal agencies and programs dealing with commodity sugar and sugar-containing product imports are summarized in table II.1 and discussed in the following sections.

Table II.1: Administration of Federal Sugar Programs and Activities

Agency	Program/Function	Activity
Executive Office of the President Economic Policy Council	Import quota	Sets annual import quota on a country-by-country basis and makes policy decisions on sugar matters.
U.S. Department of Agriculture Commodity Credit Corporation	Sugar price support	Sets nonrecourse loan rates and has overall responsibility for support program.
Agricultural Stabilization and Conservation Service	Sugar price support	Administers nonrecourse loans.
Foreign Agricultural Service	Quota and quota-exempt program administration	Administers commodity sugar import quota program, sets market stabilization prices, and issues licenses and administers programs for import of nonquota sugar for processing and reexport and for production of polyhydric alcohol.
U.S. Department of Commerce Foreign Trade Zones Board	FTZ administration	Approves establishment of and sets policies for FTZs.
U.S. International Trade Commission	Tariff setting	Writes the Tariff Schedules of the United States Annotated, a compilation of import quotas, duties, and fees to be assessed on imported merchandise.
	Investigations	Investigates imports of commodity sugar and sugar-containing products as requested by the President.
U.S. Department of the Treasury Customs Service	Selective inspection	Oversees imports of commodity sugar and sugar-containing products at ports of entry and enforces the tariff schedules.
	Audit-inspection	Audits imports of commodity sugar and sugar-containing products at FTZs, enforces FTZ Board policies, and enforces the tariff schedules.

Executive Office of the President

The Economic Policy Council, composed of a number of the President's cabinet members, recommends an annual commodity sugar import quota to the President, who makes the final decision on the import quota level.

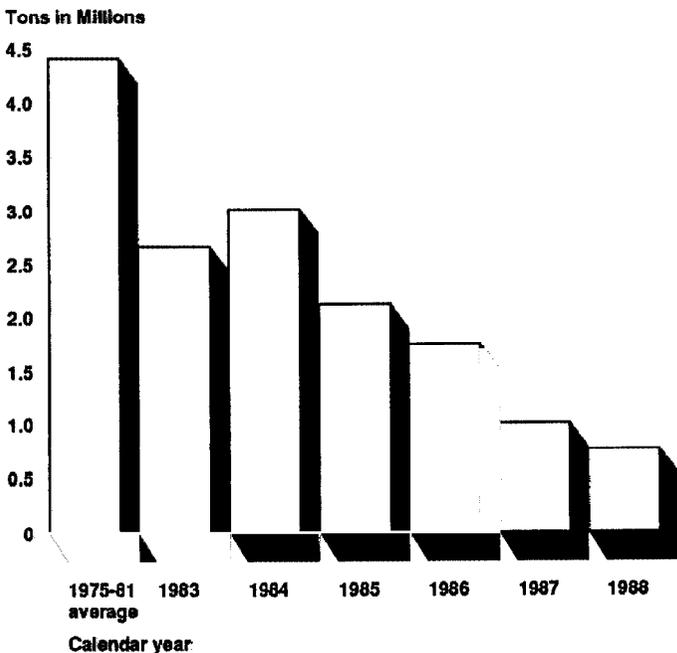
Annual Commodity Sugar Quota

The Economic Policy Council receives its sugar quota information from an interagency Sugar Working Group, which is chaired by the Under Secretary of Agriculture for International Affairs and Commodity Programs and includes officials of the Departments of Agriculture, Commerce, State, and the Treasury; the Office of Management and Budget; the Council of Economic Advisors; the National Security Council; the

U.S. Trade Representative; and the White House. Sugar import quota estimates are based on a formula derived by USDA.

The first full-year allocation under the current commodity sugar import quota system, established by Presidential Proclamation 4941 (revised) in 1982, occurred in fiscal year 1983. The countries that have quota access to the U.S. market are those that shipped sugar to the United States during the 1975 to 1981 open market period. From 1983 to 1984 the U.S. import of sugar under quota rose 13 percent but fell each year thereafter through 1988, dropping a total of 83 percent from about 4.4 million tons in the pre-quota period to slightly over 750,000 tons in 1988. The 1988 quota is down about 25 percent from the 1987 quota of just over 1 million tons. (See fig. II.1.)

Figure II.1: U.S. Commodity Sugar Import Quota, 1983-88 vs. 1975-81 Open Market Average



Sources: Sugar and Sweetener Situation and Outlook Report, ERS, USDA, Mar. 1988, table 21, and J. Womach, Sugar Policy Alternatives to Aid CBI Countries, Congressional Research Service, Jan. 29, 1988.

The sizeable 1987 and 1988 commodity quota reductions were due to the sugar program's "no cost" mandate, as established in the Food Security

**Appendix II
Federal Sugar Programs and Administration**

Act of 1985 (P.L. 99-198, Dec. 23, 1985). The act requires that beginning with the quota period starting January 1, 1987, the President shall use all available authorities to enable the Secretary of Agriculture to operate the sugar program at no cost to the federal government by preventing the accumulation of sugar acquired by USDA. The no-cost provision is designed to ensure that there are no forfeitures and thus no cost to the government. When the President signed the bill, he cited the sugar provisions as one of several highly objectionable features, stating that the mandatory reduction in the size of the sugar quota (1) is inconsistent with U.S. foreign policy objectives, (2) may be in violation of U.S. obligations under international trade agreements, and (3) threatens to severely disrupt the economies of the Caribbean nations and the Philippines.

The 1988 U.S. commodity sugar import quota is allocated to 39 countries that are predominantly developing nations in the Caribbean, South America, Africa, and the Pacific. (See table II.2.)

Table II.2: 1988 Quota Allocations by Country (Tons, Raw Value)

Country	Amount	Country	Amount
Dominican Republic	123,200	Canada	7,700
Philippines	110,600	Ecuador	7,700
Brazil	101,500	Jamaica	7,700
Australia	58,100	Malawi	7,000
Guatemala	33,600	Fiji	6,300
Argentina	30,100	Barbados	5,770
Peru	28,700	Bolivia	5,770
Panama	20,300	Congo	5,770
El Salvador	19,966	Gabon	5,770
Colombia	16,800	Ivory Coast	5,770
Costa Rica	13,110	Madagascar	5,770
Honduras	11,524	Papua New Guinea	5,770
Swaziland	11,200	St. Christopher	5,770
Thailand	9,800	Trinidad-Tobago	5,770
Mozambique	9,100	Haiti	5,770
Guyana	8,400	India	5,770
Mauritius	8,400	Mexico	5,770
Taiwan	8,400	Paraguay	5,770
Zimbabwe	8,400	Uruguay	5,770
Belize	7,700		

Source: "USDA Announces Import Quota for 1988 Quota Period," News, Office of Information, USDA, Dec. 15, 1987.

Administrative action or legislation specifically bars sugar from certain countries from entering the United States. Cuban sugar is embargoed as the result of Presidential Proclamations 3383, 3401, and 3447, issued in the early 1960s. South Africa's quota share was eliminated and entirely reallocated to the Philippines as a result of the Comprehensive Anti-Apartheid Act of 1986 (P.L. 99-440). Nicaraguan sugar is prohibited from entry to the United States under general trade restrictions imposed by Executive Order 12513, dated May 1, 1985, and continued by presidential notice on April 25, 1988. Customs enforces the U.S. sugar program import restrictions.

U.S. Department of Agriculture

Three USDA agencies—the Commodity Credit Corporation (CCC), Agricultural Stabilization and Conservation Service, and Foreign Agricultural Service (FAS)—administer the sugar price support and quota and quota-exempt sugar programs.

Price Support Program

The U.S. sugar price support program has two principal objectives: first, to provide U.S. sugar producers and processors with a guaranteed minimum price to sustain domestic production, and second, to protect U.S. consumers from the vagaries of the world market, which is characterized by wide variations in supply and demand as well as wide variations in price levels. However, because U.S. prices typically exceed world prices, this stabilization may be achieved at the expense of higher average prices for U.S. sugar purchasers. Program mechanisms include non-recourse commodity loans, a market stabilization price, and an import quota on foreign sugar (discussed in the previous section).

Under the Agricultural Act of 1949, as amended by the Food Security Act of 1985, a price support program is mandated for domestically grown sugarcane and sugar beets through nonrecourse commodity loans for cane and beet sugar available to sugar processors. To participate in the loan program, sugar processors must pay growers minimum government-established support prices for sugarcane and sugar beets. Non-recourse loans are provided through USDA's CCC, a wholly owned government entity responsible for commodity loans, commodity purchases, and other price and income supports. Because CCC does not have a staff, its activities are administered mainly by staff of USDA's Agricultural Stabilization and Conservation Service. The loans are "non-recourse," because if a processor cannot profitably repay a loan before or at its maturity, CCC takes title to the sugar as full payment of the

loan. To profitably repay the loans by selling their sugar in the market, the processors need to obtain a price that covers the loan principal (the support price) and accrued interest, as well as handling, freight, and other marketing costs.

The cane sugar support price was established in the Food Security Act of 1985 at "not less than 18 cents per pound for raw cane sugar" for the 1986 through 1990 crops. Beet sugar must be supported at a level that is "fair and reasonable in relation to" the cane sugar support price. Cane sugar was supported at the 18-cents-a-pound minimum price level in 1986 and 1987. Beet sugar was supported at 21.09 cents a pound in 1986 and 21.16 cents a pound in 1987.

If processors default on their nonrecourse loans, CCC not only takes title to the sugar in full payment of the loans but also becomes responsible for the storage and ultimate disposal of the sugar. CCC sustained a loss on 1985 sugar loan defaults of about \$90 million. In response to the loss experience, the Congress mandated in the 1985 legislation that the sugar program operate at no cost to the federal government.

To lower the risk of CCC's acquiring sugar, Presidential Proclamation 4887, dated December 23, 1981, directed that a market stabilization price (MSP) be established at a level higher than the support price. The MSP represents the price at or above which producers would be more likely to sell their sugar in the marketplace than to forfeit it to CCC. It also is used to calculate penalties and liabilities under quota-exempt sugar programs administered by USDA.

The MSP is the sum of the price support loan rate, the adjusted average transportation costs for shipping raw cane sugar, interest costs of repaying a sugar price support loan at full maturity, and two-tenths of a cent per pound marketing incentive. The procedure for calculating the MSP is specified in the Code of Federal Regulations. For crop years 1986-87 and 1987-88, USDA calculated MSPs of 21.78 cents and 21.76 cents a pound, respectively, to be the minimum market prices necessary to discourage the forfeiture of sugar to CCC.

Quota and Quota-Exempt Sugar Programs

Imports of sugar to be refined or blended into sugar-containing products for reexport purposes and for production of polyhydric alcohol were exempted from the sugar quota by Presidential Proclamation 5002, issued on November 30, 1982. USDA's Foreign Agricultural Service is responsible for the day-to-day administration of the commodity sugar

quota program and for controlling the Refined Sugar Reexport Program, the Sugar-Containing Product Reexport Program, and the Polyhydric Alcohol Program. Customs is responsible for ensuring that the sugar quota is not circumvented.

Under the Refined Sugar Reexport Program, FAS grants licenses to sugar refiners so that they may import raw sugar, exempt from the sugar quota, up to a preauthorized maximum of 50,000 tons at any one time. As raw sugar is imported, each shipment is charged against the refiner's license. Within 3 months of the entry date, the refiner must refine the imported raw sugar (or substitute other refined sugar) and export it in a quantity that is equivalent to the amount imported. FAS debits sugar from the refiner's license when the licensee proves the reexport by presenting a Customs-certified bill of lading or similar document. A refiner has the option of exporting refined sugar for credit on the license prior to receiving any imported raw sugar shipments, which places the refiner in a debit status. If a refiner chooses to first import raw sugar, that refiner is in a credit status and must be bonded for at least the level imported. Most companies that need bonding are usually covered for the 50,000-ton limit.

The Sugar-Containing Product Reexport Program operates very similarly to the Refined Sugar Reexport Program. Licenses may be granted to import nonquota sugar or transfer it from another licensee for use in sugar-containing products that will be reexported after processing. The major difference is that two types of licenses may be granted under the Sugar-Containing Product Reexport Program—a combined importer/user license or a user-only license. The importer/user licensee may import or transfer shipments of sugar up to a preauthorized maximum of 10,700 tons, raw weight. A user licensee can transfer sugar up to 10,000 tons, refined weight, from a quota-exempt source, such as a reexport refiner. The licensee has either 21 months, if the sugar was imported, or 18 months, if the sugar was transferred, to utilize and reexport the sugar in sugar-containing products. Customs-certified documents must also be presented to FAS as proof of reexport and for the debit of sugar from the license. To avoid posting bond, licensees have the option of exporting sugar-containing products before receiving non-quota sugar.

Because sugar can be continuously imported and exported, there is no maximum amount of sugar that can be processed under these programs during any given year. As of November 1987, 6 companies were licensed in the Refined Sugar Reexport Program and 140 companies were

licensed in the Sugar-Containing Product Reexport Program. According to USDA, 522,219 tons of nonquota reexport sugar entered the United States in 1986 and (less processing losses and export time allowances) 491,382 tons were reexported.

Under the two reexport programs, companies pay duties on the sugar brought into the United States and receive refunds of 99 percent of the duties when the sugar or sugar-containing products are exported. According to the head of FAS' sugar group, the practice by companies is to import sugar under license from countries for which no duties must be paid and then claim drawbacks of duties paid on past sugar shipments.

An investigation called "Operation Bittersweet," which began in 1984 and was conducted jointly by USDA's Inspector General's Office and Customs' Fraud Detection Unit, uncovered instances of fraud in documents presented to Customs on claims for the refunds. By 1987, 22 corporations and 20 individuals were convicted after the investigators found that licensed sugar refiners and export brokers were claiming to export sugar products in order to collect the 99-percent refund of the duties paid on imports of raw sugar. Instead, the shipments of sugar products turned out to be grains, flours, or nothing at all. After the convictions, fines of \$22.5 million were assessed.

Under the Polyhydric Alcohol Program, FAS grants licenses to chemical companies for the production of polyhydric alcohol, which is used in products ranging from toothpaste to dietetic foods. Federal regulations require that the alcohol be produced within 6 months from receipt of the sugar and prohibit the production of polyhydric alcohol to be used as a substitute for sugar for human consumption. As of April 1988, 14 chemical companies were licensed under the Polyhydric Alcohol Program.

U.S. Department of Commerce

In addition to being involved in the interagency Sugar Working Group, the Foreign Trade Zones Board, whose executive secretariat is in the Department of Commerce, oversees the operations of FTZs that export sugar-containing products into U.S. commerce.

Foreign Trade Zone Administration

FTZs are established by the FTZ Board under the authority of the Foreign Trade Zones Act of 1934, as amended (19 U.S.C. 81a-81u). The FTZ Board is composed of the Secretaries of Commerce, the Treasury, and the

Army, with the Secretary of Commerce as chair. Each agency representative tends to focus on issues relating to that agency's general areas of responsibility: Commerce (FTZ Board) on industry impact matters, Treasury (Customs) on control and entry matters, and Army (Corps of Engineers) on physical facility matters (e.g., adequate security measures).

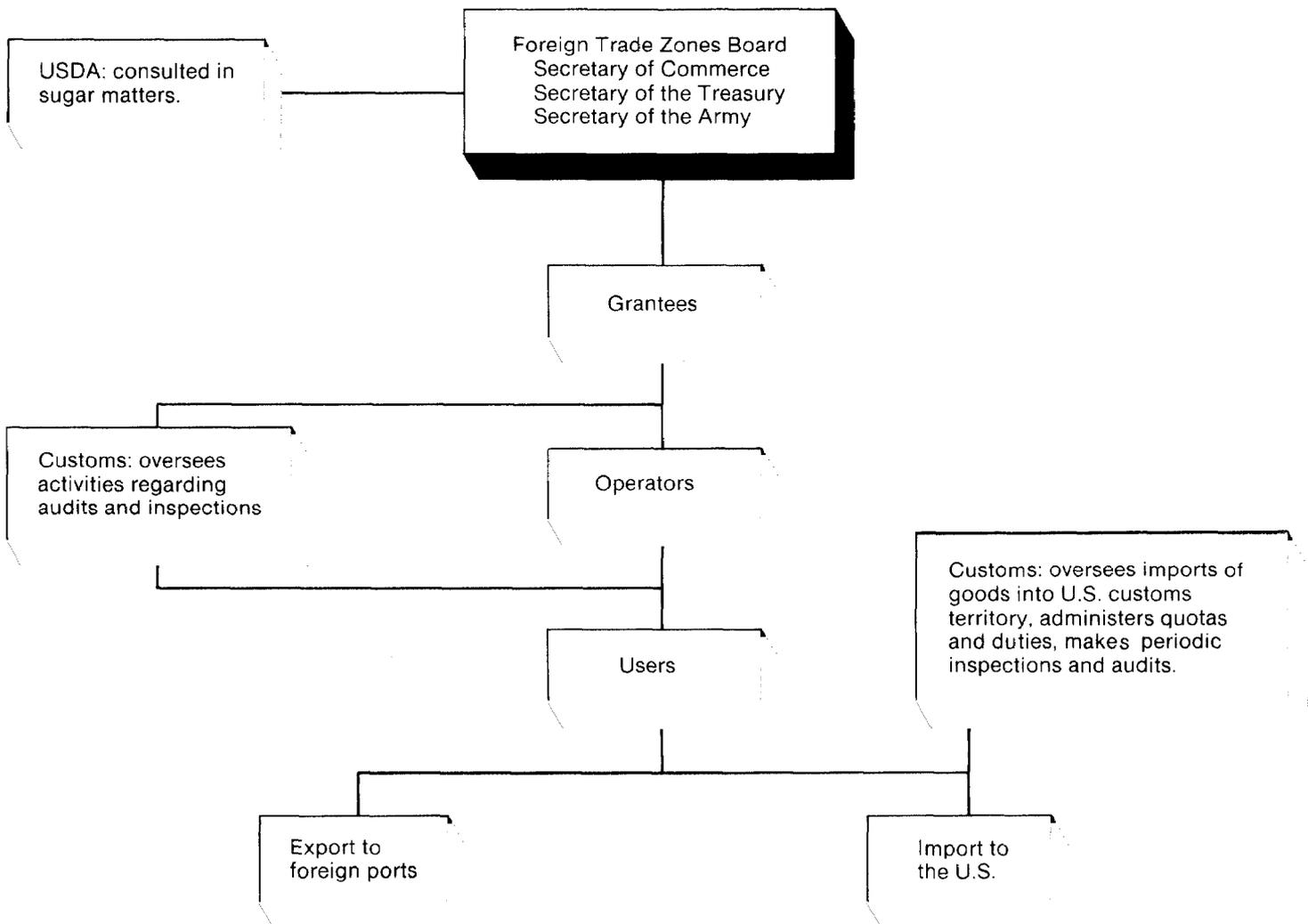
FTZ status authorizes individuals or companies in secured areas geographically inside the United States but legally outside U.S. customs territory to import merchandise free from customs duties and to use the merchandise within the rules and regulations of 15 C.F.R. part 400. The goal is to expedite and encourage U.S. participation in international trade and commerce. Participating companies may bring goods into zones for a variety of purposes, including storage, distribution, mixing with other foreign and domestic merchandise, or for use in manufacturing operations. Products may subsequently be brought into U.S. customs territory upon payment of applicable duties and compliance with other laws and regulations, including quotas. Alternatively, they may be exported without U.S. tariffs and other restrictions being applied.

There are two basic FTZ variants: general purpose zones and special purpose "subzones." General purpose zones are located within or near ports of entry (typically warehouse areas near docks or portions of industrial parks located adjacent to airports). Subzones are authorized in order to enable individual companies that cannot be accommodated within a general purpose zone (typically sizeable manufacturing concerns, such as auto assembly plants) to participate in the program. Subzones are technically subordinate parts of sponsoring general purpose zones, but are physically removed from them, sometimes considerable distances.

The law specifies that authority to operate zones is to be granted to "corporations," with preference to be given public corporations. FTZ Board regulations specify that private corporations are eligible to receive grants only if the appropriate state legislature has passed authorizing legislation. In practice, state and local port authorities are the most frequent recipients of grants, although "corporations" are sometimes created specifically for this purpose, e.g., the McAllen (Texas) Trade Zone, Inc. General purpose zone grantees apply for subzone grants on behalf of companies interested in using zone procedures. Many grantees hire "operators" to actually provide zone services to tenant firms, especially in the case of large general purpose zones. Firms conducting activities within zones are known as "users." Large manufacturing plants with subzone status may act as their own "operators." As of February 1988 the FTZ Board had authorized 139 general purpose

zones and 105 subzones. According to Commerce, the vast majority of zone activity occurs in the automobile assembly sector. Six general purpose zone users and four subzone plants were authorized to use sugar. Figure II.2 shows where federal responsibilities fall in regard to the FTZ structure.

Figure II.2: Foreign Trade Zone Structure and Federal Responsibilities



In September 1983 USDA advised the FTZ Board that it would not oppose an FTZ sugar-blending operation that resulted in a blend of less than 65 percent foreign sugar entering U.S. commerce. Using the 65-percent criterion, the FTZ Board approved seven sugar-blending operations in four zones. On August 23, 1984, USDA advised the FTZ Board that its position had changed and that it believed that all sugar-containing product manufacturing operations in FTZs for U.S. importation to be against the public interest because such operations interfered with the domestic price support program. At that time the FTZ Board decided to "grandfather" the seven companies with ongoing or approved FTZ sugar operations and set a total annual limit of 55,950 tons of sugar in products produced for domestic consumption. The basis for the "grandfathering" was that the companies could otherwise move their sugar operations outside the United States and thereby reduce domestic employment and/or that the companies had already invested in equipment. This "grandfathered" status allows the companies to use world sugar in the FTZ operations with an option to import their finished products into the United States provided the sugar content of those products does not exceed each company's portion of the annual aggregate limit. The FTZ Board requires a special annual report from Customs regarding compliance with the sugar import allocation. According to Customs' reports, the FTZ companies imported finished products containing about 20,700, 29,450, and 39,950 tons of sugar into the United States in 1984, 1985, and 1986, respectively.

Five of the original seven grandfathered companies were still active at the time of our review. (Three were active as of May 31, 1988.) They produced sugar-containing products, such as gelatin mix, drink mixes, and other sugar blends. Appropriate duties or fees are charged and import quotas are enforced if the companies' products are imported from the zones into U.S. customs territory. In addition, as directed by the conference report on the Food Security Act of 1985, USDA did not oppose and the FTZ Board approved the use of world-price, nonquota sugar at four new subzones by two companies in March 1987. These new operations are restricted to (1) importing and using nonquota sugar for reexport purposes only or (2) producing sugar-containing products that are subject to import quotas imposed by Presidential Proclamation 5294, dated January 28, 1985, as modified by Presidential Proclamation 5340, dated May 17, 1985, and were approved for a 2-year trial period subject to board review. In June 1988 Customs officials informed us that one of the new operations may be terminated at the end of the 2-year trial period, in part because of failure to meet administrative requirements of the sugar quota.

U.S. International Trade Commission

The U.S. International Trade Commission (ITC) has two roles in regard to imports of sugar and sugar-containing products. ITC writes the Tariff Schedules of the United States Annotated (TSUSA), which enumerates imported articles, including sugar and sugar-containing products, that are subject to or exempt from duty and lists duty rates (with supporting legal text and statistical annotations) that are to be assessed on such articles. ITC also investigates imports of products, including sugar and sugar-containing products, as requested by the President or the Congress, to determine whether imports of such articles are or will be materially interfering with USDA programs or substantially reducing U.S. processing of such articles.

Sugar Duty and Import Quota Setting

ITC's authorities for issuing TSUSA are found in section 201, Tariff Classification Act of 1962, as amended (P.L. 87-456), and the Tariff Act of 1930, as amended (19 U.S.C. 1484(e)). As modifications and amendments occur, ITC updates TSUSA. The TSUSA, which comprises more than 1,000 pages, is interpreted and enforced by the U.S. Customs Service.

Duty rates and quotas on imports of raw and refined sugar are authorized by schedule 1, part 10, subpart A of TSUSA, commonly referred to as the "headnote" authority. The headnote authority authorizes the President to impose duty rates and quotas on sugar at the same time and basically echoes the contents of Presidential Proclamation 4941 (revised), which establishes the country-by-country import quota. TSUSA also contains import restrictions on certain sugar-containing products, including import quotas and fees on such categories as (1) flavored sugars, syrups, and molasses, and flavored or unflavored syrup blends and (2) pancake and other flour mixes.

Investigations

In 1983 and 1985 the President asked ITC to investigate certain imports of sugar-containing products. Such investigations are authorized under section 22 of the Agricultural Adjustment Act of 1933, as amended (7 U.S.C. 624), which is intended to provide relief where imports are found to materially interfere with a U.S. price support program. Simultaneously, through emergency action, the President implemented quotas on certain categories of sugar-containing products pending the outcome of ITC's investigations.¹ The emergency actions were taken after USDA concluded that certain sugar-containing product imports were practically

¹Through Presidential Proclamations 5071, June 28, 1983, and 5294, Jan. 28, 1985, as modified by Presidential Proclamation 5340, May 17, 1985.

certain to materially interfere with the U.S. sugar price support program. ITC released its 1983 investigation's findings and recommendations to the President in December 1983. The 1985 investigation's findings and recommendations were sent to the President in October 1985 but remained unavailable to the public as of May 1988. The emergency action quotas, however, remain in effect.

The 1983 emergency action set zero quotas (no imports allowed) on certain sugar-containing products that were capable of being further processed or mixed with other ingredients and that were not prepared for marketing to retail consumers in the identical form and package in which they were imported. These products included blended syrups and articles, such as sweetened cocoa, pancake and other flour mixes, and certain other edible preparations, with a sugar content of over 65 percent, dry weight. The 1985 emergency action, which continued the 1983 zero quotas, also imposed volume quotas on some of the same products when their sugar content was over 10 percent (and under 65 percent), dry weight. These quotas were 3,000 tons on sweetened cocoa, 7,000 tons on pancake and other flour mixes, and 84,000 tons on other edible preparations (with certain exceptions). These quotas are outlined in Part 3 of the Appendix to the TSUSA.

U.S. Department of the Treasury

The U.S. Department of the Treasury's Customs Service is responsible for collecting revenues on imports as established in TSUSA and for preventing improper entry of goods. Customs responsibilities include overseeing imports of sugar and sugar-containing products at ports of entry and FTZs and enforcing TSUSA and FTZ Board policies, which it does through its selective inspection and audit-inspection programs. Customs, whose headquarters is in Washington, D.C., has seven regions in the United States (including Puerto Rico and the Virgin Islands). Within the regions are 44 subordinate district or area offices and under these are about 240 ports of entry.

Selective Inspection

When a ship, plane, train, or truck carrying cargo arrives within the limits of the country, its arrival must be reported to Customs. From 1842 to the early 1980s, Customs' policy was to inspect a portion of every importer's shipment. In 1981 the Department of the Treasury amended Customs' regulations relating to the examination of imported merchandise (19 C.F.R. part 151) to allow Customs to establish systems

whereby only high-risk shipments are physically examined by inspectors. Other shipments may be released without physical examination.²

Audit-Inspection

Customs' role regarding FTZ and subzone operations is to maintain appropriate supervision of merchandise and records and ensure the collection of revenue. Over the past few years, Customs has revised its supervisory role in FTZs and subzones.

In August 1983 Customs implemented a pilot program, called the audit-inspection program, to revise its oversight operations. The program, which became fully operational in May 1986, de-emphasized Customs' physical presence in zones to accommodate a rapid increase in the number of FTZs and subzones, and a simultaneous decrease in the number of Customs officers who performed supervisory duties. The audit-inspection program replaced physical, on-site inspection with a system based on spot checks and audits. Since Customs removed its on-site presence from the FTZs, it has relied heavily on the FTZ grantees, their designated operators, and users to comply with applicable regulations, subject to liquidated damages for failure to comply. Under the audit-inspection program, Customs needs fewer personnel to supervise the FTZs and subzones, and grantees have greater flexibility to admit, transfer, or process merchandise.

The specific audit-inspection duties that Customs is authorized to perform, as described in 19 C.F.R. part 146, include

- activating FTZ operations after FTZ Board approval and suspending FTZ operations;
- supervising authority over admitting, handling, and removing merchandise in zone status;
- detailing or assigning Customs officials to a zone, as necessary, to maintain appropriate Customs supervision and to protect the revenue;
- performing periodic audits of zone operators' records; taking quantity counts of goods in a zone inventory; spot checking selected transactions or procedures; or reviewing recordkeeping, security, or conditions of storage;
- authorizing an operator to break or affix Customs in-bond seals;
- physically examining merchandise either at time of entry into the zone or at any time thereafter;

²For additional information on selective inspections, see Cargo Imports: Customs Needs to Better Assure Compliance With Trade Laws and Regulations (GAO/GGD-86-136, Sept. 8, 1986).

-
- controlling the transportation through Customs territory of merchandise that is destined for a zone; and
 - controlling the admission of merchandise into a zone.

Customs' application of these oversight responsibilities is discussed in appendix V.

GAO Estimates of Sugar Entering the United States in Sugar-Containing Products

On the basis of import data and information provided by government and sugar industry experts, we estimate that between 265,000 tons and 307,000 tons of sugar that may have displaced domestic sugar were contained in products imported in 1986 under 46 tariff categories. Canada was the principal country of origin for these sugar-containing products. The estimated sugar amount for 1986 represents an increase of about 160 percent above the estimated 103,000 tons to 118,000 tons of sugar imported in such products in 1982, when the current quota system for commodity sugar imports went into effect. The 1986 amount is equal to 4 percent to 5 percent of that year's domestic sugar production of 6.26 million tons.

How We Selected Tariff Categories and Estimated Amounts of Products and Sugar Content

We could not develop precise statistics on the amount of sugar imported in sugar-containing products because industry formulas for such products are considered proprietary information. However, with the subcommittee staff's agreement, we developed a list of imported products containing sugar that could be displacing domestic sugar and estimated the products' sugar content. The products are classified, for customs purposes, in 46 tariff categories established in the Tariff Schedules of the United States Annotated.

We based our import category selections on views and information provided by government and industry experts. Expert sources included USDA; ITC; the consulting firm of Abel, Daft, and Earley; and Amstar Sugar Corporation, a major sugar producer. Each of these sources had previously prepared its own estimate(s) of sugar imported in sugar-containing products. (See app. IV.)

To estimate the amounts of products in the import categories, we used Bureau of the Census import data. To establish the data's reliability, we reviewed the data with the U.S. Customs Service, which collects the data, and with the Bureau of the Census, which compiles and reports the data.

Customs collects import information on a Customs form that is used in every import entry package. A copy is sent to Census for data compilation purposes. The Assistant Chief of Census' Foreign Trade Division told us that he believes Customs closely scrutinizes the data before they are communicated to Census. However, Customs' Commercial Compliance Division Chief told us that the information on the form is based on preliminary data collected when importers apply to enter their merchandise into the United States and before the information is verified. He

added that Census is sent corrected information in cases in which merchandise is valued at over \$50,000 but that he did not believe Census uses the corrected information. The Assistant Chief of Census' Foreign Trade Division said that he recognizes the process is controversial but that, overall, he believes the data to be accurate and reliable.

After initial consultation with the government and industry experts, we began our analysis with a universe of sugar-containing products in several broad product groups, such as jams and jellies, confectioners' coatings, and candy and confectionery. Because some of the experts we contacted said that the sugar in some items in the broad groups did not displace domestic sugar, we refined our list to exclude such items. For example, we deleted import data on guava and kumquat jellies from the jams and jellies product group because experts consider those jellies to be imported specialty items and the sugar in them to not displace domestic sugar. In general, the experts we contacted pointed to sharp increases in the import levels of certain sugar-containing products as the primary basis for their product selections. They considered these increases as evidence that sugar product imports had displaced domestic sugar because, in many cases, the large increases coincided with the implementation of sugar and sugar-containing product quotas and tariff limits.

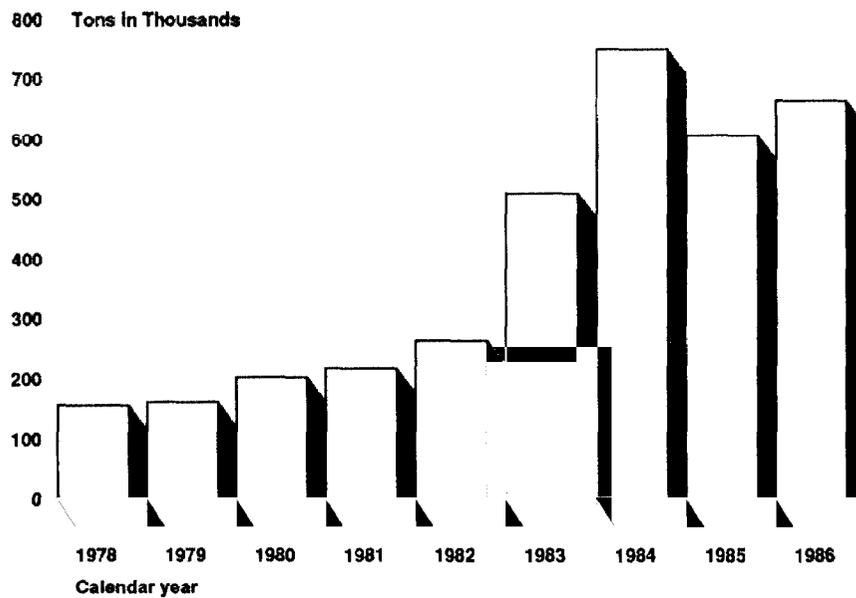
Because ingredient formulas for most products are considered proprietary information and the experts we contacted disagreed on the percentage of sugar in products in some of the product groups, we used a range of percentages to estimate the aggregate amount of sugar that entered the United States in the product groups. For example, ITC told us that the sugar content of some products in the candy and confectionery product group ranged from 50 to 80 percent. USDA estimated a sugar content of 50 percent for such products, and Abel, Daft, and Earley estimated 60 percent. Because of the various estimates, we used a range of 50 to 80 percent for our estimate.

What Our Estimates Showed

Our estimates showed that for the selected product groups, imports of products containing sugar that may have displaced domestic sugar increased significantly after 1982, the year in which the current sugar import quota system went into effect. As figure III.1 shows, the volume of products in the selected product groups increased from about 261,500 tons in 1982 to about 666,400 tons in 1986, about a 155-percent increase.

Appendix III
GAO Estimates of Sugar Entering the United
States in Sugar-Containing Products

Figure III.1: Volume of Sugar-Containing
Product Imports in Selected Product
Groups, 1978-86



Source: Developed from Bureau of the Census data.

Table III.1 shows the broad product groups and the number of tariff categories under those groups that we included in estimating the amount of sugar imported in sugar-containing products; the estimated percentage of sugar in products in each group; and for calendar years 1982 and 1986, the volume of products for each group and the estimated amount of sugar in those products.

**Appendix III
GAO Estimates of Sugar Entering the United
States in Sugar-Containing Products**

Table III.1: Sugar Content of Products in 46 Tariff Categories That Displace Domestic Sugar, 1982 and 1986

(Tons in Thousands)

Import category	Number of tariff categories	Estimated sugar content (percent)	Calendar year 1982			Calendar year 1986		
			Total volume	Sugar content		Total volume	Sugar content	
				Low	High		Low	High
Jams, jellies, and preserves	14	55	3.4	1.9	1.9	20.2	11.2	11.2
Candied fruit and nuts	9	70	3.7	2.6	2.6	5.7	4.0	4.0
Flavored sugar, syrups, and molasses	2	94	14.5	13.6	13.6	22.0	20.6	20.6
Sweetened chocolate	5	50	23.4	11.7	11.7	60.3	30.1	30.1
Sweetened cocoa	6	14	2.1	1.4	1.4	1.6	1.1	1.1
Confectioners' coatings	1	50	1.0	.5	.5	5.6	2.8	2.8
Candy and confectionery without chocolate or cocoa	3	50-80	45.5	22.7	36.4	114.5	57.2	91.6
Candy and confectionery with chocolate or cocoa	3	40	17.7	7.1	7.1	30.2	12.1	12.1
Biscuits, cakes, and wafers	1	25	64.8	16.2	16.2	138.7	34.7	34.7
Breakfast cereal	1	20	12.7	2.5	2.5	11.0	2.2	2.2
Sauces	1	25	19.8	5.0	5.0	29.9	7.5	7.5
Edible preparations of gelatin	1	70-90	2.0	1.4	1.8	25.2	17.6	22.7
Edible preparations, over 5 percent butterfat	1	56-90	1.2	.7	1.1	2.2	1.2	2.0
Pancake and other flour	1	20-40	4.3	.9	1.7	11.5	2.3	4.6
Other edible preparations	2	a	45.4	14.5	14.5	187.8	60.1	60.1
Total^b	46		261.5	102.7	118.0	666.4	264.7	307.3

^aAssumes 10 percent contains 95 percent sugar, 40 percent contains 50 percent sugar, and 50 percent contains 5 percent sugar.

^bTotals may not add because of rounding.

As table III.1 shows, we estimate that the sugar content of the imported products ranged from about 103,000 tons to about 118,000 tons in 1982 and from about 265,000 tons to about 307,000 tons in 1986, or an increase of about 160 percent. The estimated amount of sugar for 1986 is about 4 percent to 5 percent of that year's domestic sugar production of 6.26 million tons.

Some industry experts told us that they believed the actual amount of sugar imported in the sugar-containing products in our list may be somewhat greater than our high aggregate estimate because the low cost of foreign sugar creates a price incentive to import highly saturated sugar blends. For example, a few experts told us that they suspected that some imported sugar-containing products are saturated with sugar so that sugar industry users can take advantage of cheaper world-price

Appendix III
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sugar and later dilute the product with domestic ingredients other than sugar. One expert, for example, said that there is considerable potential for jam and jelly producers to import strawberry jam base from Mexico that is heavily concentrated with sugar and later to cut the concentration by adding more strawberries after the base is imported. According to a Customs official, the sampling rate is less than 1 percent of sugar-containing product import shipments, and because lists of product ingredients are proprietary, we have no means of verifying the extent of such circumvention.

Our analysis also showed that imports of some specific sugar-containing products had increased dramatically since the current sugar import restrictions took effect. These included gelatin/sugar mix imports and imports of sweetened chocolate bars weighing more than 10 pounds. (See app. V for additional information on these products.) The tariff categories with the greatest percentage increases and decreases between 1982 and 1986 are shown in table III.2.

Table III.2: Tariff Categories Showing the Greatest Increases and Decreases Between 1982 and 1986

Tariff category	Description	Percentage change
156.25	Bulk sweetened chocolate bars (10 pounds or over)	+1,345
182.90	Edible preparations of gelatin	+1,148
153.03	Currant and strawberry jelly	+1,145
156.3020	Sweetened chocolate bars—retail size (less than 10 pounds)	- 24
156.45	Sweetened cocoa	- 23

Source: Developed from Bureau of the Census data.

Other Government and Private Estimates of Imported Sugar in Sugar-Containing Products

In developing our estimates of imported sugar in sugar-containing products, we examined estimates provided by USDA; ITC; Abel, Daft, and Earley; and Amstar Sugar Corporation. Table IV.1 shows the estimates. Additional information on each study and how we used it in arriving at our estimates is discussed following the table.

Table IV.1: Other Government and Industry Estimates of Sugar in Sugar-Containing Products

Entity making estimate	Period analyzed	Estimate ^a (tons)	No. of tariff schedule items	Comments
USDA	FY 1986	950,000	149	Assumed 50% sugar for all items. Included high fructose corn syrup, breads, and animal feed. Excluded all juices and beverages.
USDA	FY 1987	857,000	149	Used varying sugar content by item. Included high fructose corn syrup, breads, and animal feed. Excluded all juices and beverages.
USDA	FY 1987	650,000	148	Used varying sugar content by item. Included breads and animal feed. Excluded high fructose corn syrup, all juices, and beverages.
ITC	5/82-6/83	See comments	43	Estimated 67,000 tons for 2 items. Said rest too "sketchy" to define.
ITC	9/84-8/85	122,000 to 170,000	9	Included only items being considered for quota.
Abel, Daft, and Earley	1985	290,000	16	Included canned pineapples.
Amstar	1985	730,000	16	Assumed 65% sugar for all items. Included dextrose, high fructose corn syrup, maple syrup, animal feed, and sugars and syrups not principally of crystalline structure and not in dry amorphous form.

^aThe estimates cannot be directly compared with each other or with our estimate because each of those making an estimate used different tariff schedule items or import categories.

U.S. Department of Agriculture

USDA included its fiscal year 1986 estimate of the amount of sugar imported in sugar-containing products with the proposed "Sugar Program Improvements Act of 1987" submitted to the Congress in March 1987. USDA's Foreign Agricultural Service compiled the list of about 150 tariff schedule items and indicated that the best guess, on average, for all product groups was a 50-percent sugar content. An FAS official told us that FAS' best estimate was that the volume of items containing less than 50 percent sugar balanced the volume of items containing more than 50 percent sugar. FAS' aggregate estimate showed that sugar in the imported categories increased from just over 370,000 tons in fiscal year 1982 to roughly 950,000 tons in fiscal year 1986, more than a 150-percent increase.

USDA's estimate reflects the amount of sugar and alternative sweeteners being imported in sugar-containing products irrespective of whether domestic production is being displaced and, as such, should be considered a conservatively high estimate. We did not include many of USDA's product categories in our analysis because our scope was limited to estimating the amount of sugar in sugar-containing product imports that displaces domestic sugar. Other experts we spoke with told us that they did not consider many of the products in USDA's fiscal year 1986 estimate, such as animal feeds, breads, wheat gluten, and high fructose corn syrup to be ones that directly displace domestic cane and beet sugar. For example, many experts pointed out that imported corn syrup would more directly displace corn syrup. According to the FAS official, it is difficult to evaluate whether any particular product has the potential to interfere with domestic price support operations. He said that it is difficult to measure, in the absence of individual product import bans, whether consumer demand for a particular product (e.g., canned pineapples in sugar syrup) would be filled by canning a mixture of domestic sugar with domestically available or imported pineapples.

In its fiscal year 1987 estimates, USDA used varying sugar content estimates for various tariff schedule items and derived estimates of 857,000 tons when high fructose corn syrup was included in the calculations and 650,000 tons when high fructose corn syrup was excluded.

U.S. International Trade Commission

In 1983 and 1985 the President, under section 22 authority of the Agricultural Adjustment Act of 1933, directed ITC to investigate imports of sugar-containing products and set emergency quotas on certain sugar-containing products. ITC reports on both investigations were entitled Certain Articles Containing Sugar.

In the 1983 investigation ITC considered 43 tariff categories for its report. ITC estimated that products imported from May 1982 through June 1983 in two tariff schedule items placed under emergency quotas on June 28, 1983, by Presidential Proclamation 5071 (other edible preparations not specifically provided for, 183.05, and flavored syrups and sugars, 155.75) contained about 67,000 tons of sugar (raw sugar value). ITC concluded that the estimates of the other import categories subject to investigation but not subject to emergency quotas were too "sketchy" to arrive at an aggregate sugar content estimate. We included in our estimates the two tariff schedule items for which ITC made estimates and most of the other tariff schedule items ITC reviewed in its 1983 investigation. The items we did not include in our estimate included one

jam/jelly category and carbonated soft drinks and certain other nonalcoholic beverages because experts we spoke with did not consider the items to displace domestic sugar.

For the 1985 investigation, ITC considered nine tariff schedule items of sugar-containing products as requested by the President on March 22, 1985. Imports from these categories amounted to 122,000 tons to 170,000 tons from September 1984 through August 1985.

Abel, Daft, and Earley

The consulting firm of Abel, Daft, and Earley estimated the amounts of sugar imported in products in 16 tariff schedule categories for 1982 and 1985. The firm's report stated that sugar imported through these products displaced domestic sugar and had increased from an estimated 96,000 tons in 1982 to 290,000 tons in 1985. We included all but one of Abel, Daft, and Earley's tariff schedule items (canned pineapples) in our estimate. We did not include canned pineapples because other experts did not believe that the sugar in the product displaces domestic sugar.

Amstar Sugar Corporation

Amstar estimated the sugar content of 16 tariff schedule items entering the United States from 1975 through 1985. For all items Amstar used a sugar-containing estimate of 65 percent. According to its estimates, in 1985 just over 730,000 tons of sugar entered the United States in sugar-containing products. We included in our estimate 11 of the 16 tariff schedule items that Amstar had included in its estimates. We did not include dextrose, high fructose corn syrup, maple syrup, animal feed, and sugars and syrups not principally of crystalline structure and not in dry amorphous form.

Cases Involving Controls Over Sugar-Containing Product Imports

The system through which sugar imports flow is highly complex. Authorized sugar imports can enter through FTZs and subzones or ports of entry, and the sugar can be either in a raw or refined state or in sugar-containing products. Sugar importers are required to comply with legislative and administrative requirements, including federal embargoes and quotas, before the product can make its way to the U.S. sugar-using industry or U.S. consumers, or be reexported. Figure V.1, which depicts the flow of sugar imports, shows the points at which embargoes, quotas, and other limitations are applied.

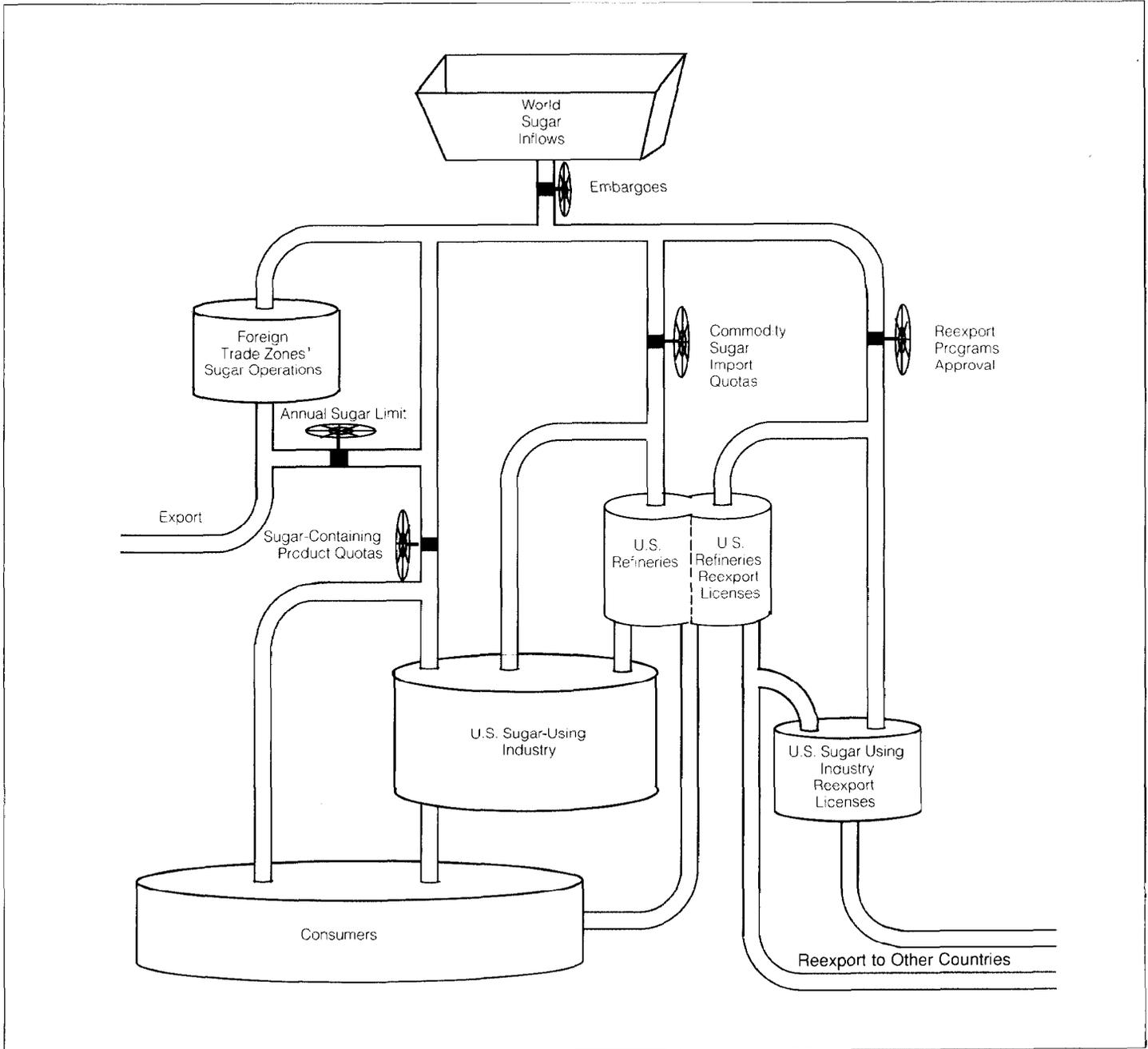
We found weaknesses in Customs controls at some FTZs and ports of entry that provided opportunities for businesses to enter sugar into U.S. commerce outside authorized avenues. At the same time, the U.S. tariff schedules allow resourceful businesses to “tailor” products to meet the most advantageous duty and/or quota classifications. Because of time constraints, the lack of an “audit trail,” and/or the data’s proprietary nature, we were unable to quantify the amount of sugar involved in most of these cases. However, because of the complexity of the sugar inflow system, the large number of TSUSA classifications and Customs regulations, and the nature of the situations discussed below, we believe the situations demonstrate problems related to TSUSA classifications and Customs internal control systems at the time of our review. Under certain circumstances we found that Customs did not always enforce its regulations and procedures. After we discussed these situations with Customs, it took action to correct some of the deficiencies.

Classifications May Result in Avoidance of Sugar Import Quotas

Since the current quota system for commodity sugar imports went into effect in 1982, imports of sugar-containing products have increased substantially. To curb imported sugar-containing products’ interference with the domestic sugar price support program, import quotas were implemented for certain sugar-containing product categories in 1983 and 1985. (See discussion in app. II of ITC activities.) Customs’ stated position is that the intent of the sugar-containing product quotas was to prohibit the entry of certain mixes of cane and beet sugar with other ingredients that suddenly appear in the marketplace and threaten to undermine the sugar price support program. In some cases, however, slight changes to the form or recipe of sugar-containing products permitted the products to meet low-quota or no-quota tariff categories.

**Appendix V
Cases Involving Controls Over Sugar-
Containing Product Imports**

Figure V.1: Sugar Import Flows



Case 1: Altering a Sugar Blend to Meet a More Favorable TSUSA Category

After the President set import limits on three sugar-containing product categories in January 1985, two FTZ manufacturers slightly altered their sugar blends so the blends would fall within TSUSA categories more favorable to the manufacturers.

The first manufacturer had been producing a blend of corn syrup and sugar in an FTZ. As long as the sugar content remained under 65 percent, the blend could be classified as an edible preparation not specially provided for,¹ and it was not subject to the granulated sugar quota.² However, as a result of the President's January 1985 action, that blend fell under a new quota for sugar-containing products.³ According to the plant supervisor, the manufacturer then adjusted its manufacturing process to add a very small amount of a fruit flavoring to the blend in the FTZ rather than adding it after the semiprocessed product was imported into the United States. In May 1985, relying on the literal wording of tariff provisions as well as the legislative background, Customs ruled that the new corn syrup/sugar/fruit-flavored blend was a flavored syrup,⁴ constituting a new and different product, which is not subject to the import quota and which is dutiable at a lower rate. According to Customs officials, the change was approved after the manufacturer had threatened to move its FTZ operation to another country. In January 1987 counsel for the firm stated that if the company's FTZ activities were curtailed, the result could be the elimination of 650 U.S. jobs.

The quota applicable to the blend before the flavoring was added in the FTZ closed within 7 months, 3 months, and 2 days, respectively, in fiscal years 1986, 1987, and 1988. In addition to being allowed to avoid the sugar-containing product quota, the FTZ manufacturer also paid a lower duty on the new product—40 percent lower in 1987. Customs estimated one 1986 shipment to the producer's FTZ operation at about 1,650 tons, including 1,000 tons of sugar. This example demonstrates how it is possible to avoid sugar import quotas.

¹TSUSA item 183.05—Edible preparations not specially provided for (including prepared meals individually packaged), other.

²TSUSA item 155.2025—Sugars, syrups, and molasses, derived from sugar cane or sugar beets, principally of crystalline structure or in dry amorphous form, in a form suitable for immediate human consumption without further refining.

³TSUSA item 958.18, which sets a quota of 84,000 tons on products (with certain exceptions) under TSUSA item 183.05.

⁴TSUSA item 155.7520—High fructose syrup derived solely from starches.

In a similar case, another FTZ manufacturer imported fruit-flavored blended syrups in bulk form from its Canadian subsidiary for consignment to a variety of domestic firms. In October 1986 the FTZ Board had denied this manufacturer permission to produce the blended syrups in the FTZ. The manufacturer then transferred its blending operation to an affiliated company in Canada. In its ruling approving the bulk imports, Customs did not address why the tariff schedule on imports of certain blended syrups⁵ did not apply, and it did not explain the reasoning. Examples of bulk sugar blends the manufacturer imported from Canada that were classified under the flavored blend category⁶ included blends of 51-percent sugar and 49-percent orange concentrate; 64-percent sugar, 35-percent fructose, and 1-percent lemon-lime extract; and 64-percent sugar, 35-percent fructose, and 1-percent cola flavoring, none of which are sold to retail customers without further processing.

Case 2: Retail Packages Approved for Sugar/ Dextrose Blends but Not for Other Products

Because of the number of factors governing the classification of sugar-containing products, including complicated quota provision language, legislative intent, and the fundamental tariff concept that merchandise is appraised and classified in its condition as imported, TSUSA classifications are numerous, complex, and confusing, and leave loopholes under which businesses can “tailor” products to meet the most favorable tariff classification. For example, under four tariff schedule items,⁷ blended products containing more than 65 percent (by weight) sugar, such as a 66-percent sugar/34-percent dextrose blend, can be imported quota-free if packaged for marketing to retail consumers,⁸ but identical blends imported in bulk containers to be packaged domestically are prohibited. This classification contrasts with tariff schedule classifications for sweetened chocolate bars, which give preferential treatment to bulk shipments over retail sale bars.

⁵TSUSA item 958.10 prohibits imports of blended syrups capable of being further processed or mixed with similar ingredients and not prepared for marketing to retail consumers in the identical form and package in which imported.

⁶TSUSA item 155.75—Flavored sugars, syrups, and molasses, and flavored or unflavored syrup blends.

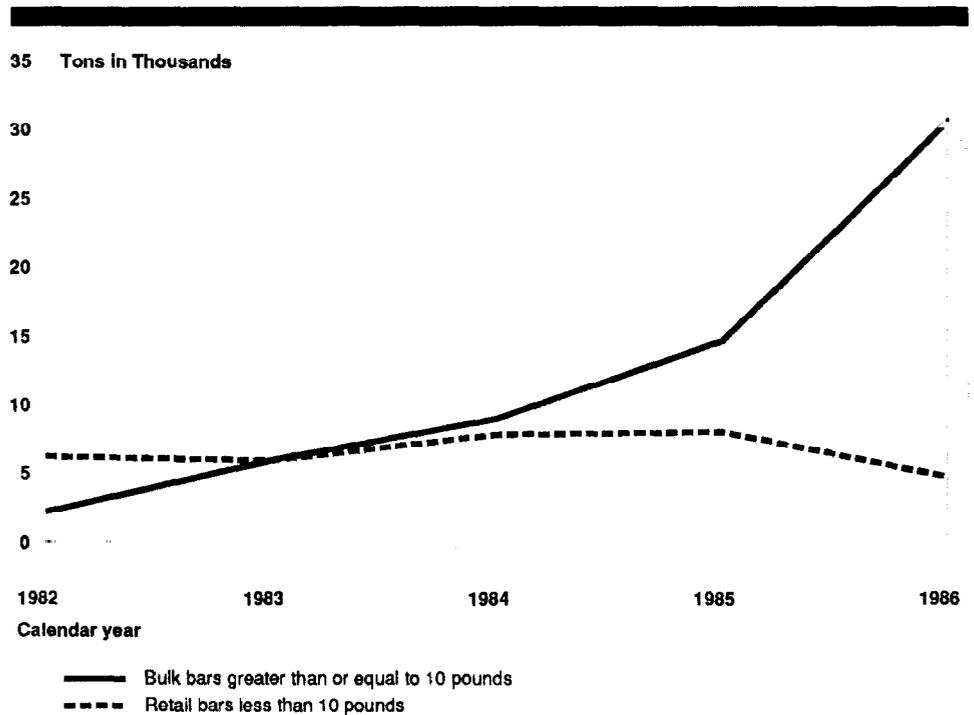
⁷TSUSA items 155.75—Flavored sugars, syrups, and molasses, and flavored or unflavored syrup blends; 156.45—Sweetened cocoa; 183.01—Pancake flour, other flour mixes, and refrigerated (including frozen) doughs; and 183.05—Edible preparations not specially provided for (including prepared meals individually packaged), other.

⁸Such products may be subject to TSUSA item 958.18, which sets a quota of 84,000 tons on products (with certain exceptions) under TSUSA item 183.05.

**Appendix V
Cases Involving Controls Over Sugar-
Containing Product Imports**

Between 1982, when the current sugar import quota system went into effect, and 1986, imports of sweetened chocolate bars weighing 10 pounds or more increased nearly 1,345 percent. During the same period imports of sweetened chocolate bars weighing less than 10 pounds, which are subject to import restrictions, decreased by about 24 percent. Figure V.2 contrasts the import levels for the two tariff categories for sweetened chocolate bars for 1982 through 1986.

**Figure V.2: Imports of Sweetened
Chocolate Bars, 1982-86**



Source: Developed from Bureau of the Census data.

For some other sugar-containing products, the size of the package or whether the product is packaged for retail sale is immaterial. For example, gelatin/sugar mixes that are 90 percent or more sugar are routinely imported in bulk packages for further manufacturing without being subject to quota.

Gelatin/sugar mix can be categorized under one of two tariff classifications—under a specific gelatin import category if the value of the gelatin exceeds the value of the sugar in the mix,⁹ or under a catchall category for a variety of blended sugar products, including gelatin/sugar mixes, if the value of the sugar exceeds the value of the gelatin.¹⁰ Gelatin/sugar mix imported under the gelatin import category is subject to a lower import duty, compared with that under the catchall category, and is not subject to any import quotas.¹¹

Between 1982 and 1986 gelatin/sugar mix imports classified under the gelatin import category increased by about 1,150 percent. By comparison, imports under the catchall category increased by about 315 percent between the same years. We could not determine how much gelatin/sugar mix had been included in the catchall category.

Customs Oversight Is Needed to Control Sugar Import Operations

According to Customs headquarters officials, the Customs Service is concerned about sugar and sugar-containing product imports that could circumvent or avoid duties, quotas, or embargoes, and has taken actions as incidents occurred. However, because of limited staff and the need to focus on other imports, sugar imports have not received a high priority. We identified a number of paperwork verification, testing, and inspection control weaknesses that had resulted in or had the potential to result in nonquota or embargoed sugar and sugar-containing products entering U.S. commerce through FTZs and ports of entry.

Case 3: End-Use Certificates Are Not Adequate to Ensure a Sugar Blend's Commercial Identity

In 1984 a Customs investigation disclosed that an FTZ manufacturer was mixing sugar and corn syrup solids in the FTZ; moving the mixture across a "yellow line" in a warehouse, which separated the FTZ from U.S. territory; sifting out the corn syrup solids in order to use the world-price sugar for other products blended in U.S. territory; and then moving the corn syrup solids back into FTZ territory to be reused in the next batch of

⁹TSUSA item 182.90—Edible preparations not specially provided for (including prepared meals individually packaged), of gelatin.

¹⁰TSUSA item 183.05—Edible preparations not specially provided for (including prepared meals individually packaged), other.

¹¹According to Customs, one region's tests of a number of samples of an FTZ user's gelatin/sugar mixes had determined that the chief value was not gelatin and as a result the related blend was identified as sugar and denied entry into U.S. commerce. Customs said that the FTZ user ceased operations after it could not consistently meet blending requirements.

the "mix." In an effort to eliminate such practices, Customs' Classification and Value Division issued a directive in November 1984. The directive stated that the commodity sugar quota would be applied to the sugar portion of blended sugar imports that did not have a "valid commercial identity" (i.e., were not marketable in their current form) or were not actually used in the commerce of the United States, either as consumer products or for further manufacturing in the same form in which they were entered. The directive applied to sugar blends entering the country across international boundaries as well as through FTZs.

The directive further provided that Customs import specialists should not allow sugar blends to enter until they were satisfied that all criteria for admission were met. Once the blends were released, the import specialists were expected to aggressively follow up to ensure validity of identity and actual use. In a separate memorandum, Customs headquarters suggested that the import specialists obtain end-user certifications as to valid commercial identity.

Import specialists at Customs' Chicago and Toledo offices told us that they typically accepted end-use certifications at face value and rarely visited end-use food plants to follow up on how the sugar blends were used in further manufacturing. We found two instances in which we question whether end users had properly met Customs' valid commercial identity requirement.

In the first instance the Customs region did not evaluate whether another end user may have altered the ratio of sugar to the blended ingredients. This company imported a sugar/flour blend,¹² which it used to manufacture a variety of bakery products for the military. The military specifications for the bakery products include sugar and flour, but in different ratios than the blend entering the country. The Customs port director in Toledo acknowledged that customers of an FTZ firm were altering the ratio of sugar to other ingredients, but he said that he was not successful in having Customs investigators follow through on his request to investigate.

In a second instance we found that the Customs region was not enforcing the November 1984 directive and Customs officials were unable to provide us with records showing Customs' approval of a company's blending operations in an FTZ. The lack of documentation was especially crucial with respect to the mixing of sugar and corn syrup solids in that

¹²TSUSA item 183.01—Pancake flour, other flour mixes, and refrigerated (including frozen) doughs.

trade zone during 1985 and 1986. We noted that the company had mixed about 1,100 tons of corn syrup solids with sugar in 1986. However, in the annual report to the FTZ Board, the Customs district did not make the required reference to this blending operation. The end-user certification dated October 1985 stated that the ratio of sugar to corn syrup solids was 63/37, but it did not explain what the end use would be. Regional Customs officials told us that they did not believe much of a market existed for sugar blends containing about 65 percent sugar and 35 percent corn syrup solids and that they did not recall ever seeing such a blend imported prior to the 1985 restrictions on sugar-containing products. In December 1987 an assistant regional commissioner told us that the region did not plan to follow up on how the blend had been used because it considered the 1984 directive to be "largely superficial."

In June 1988 Customs headquarters informed us that the 1984 directive was rescinded in February 1988. Customs' basis was that because the products in question were subject to the 1985 emergency quota for sugar-containing products,¹³ the quota provisions obviated the need for end-use certification. An International Trade Commission official told us, however, that he disagreed with the decision to rescind the directive for two reasons. First, he said that the new policy eliminates the control added in response to the "yellow line" case, thereby enabling an FTZ's customer to purchase a sugar/corn syrup solids blend and then sift out the corn syrup solids to take advantage of the cheaper world-price sugar. Second, he said that allowing such blends that have no commercial identity to come in under the quota circumvents the original intent of the presidential proclamation, which was to allow the blending of products that were historically produced to continue to be produced. He said that the fact that products with questionable commercial identity are being allowed in under the emergency quota helps explain why the quota closed in 2 days in fiscal year 1988.

Case 4: Sugar Entering Foreign Trade Zone Was Not Always Accounted For

Sugar shipments entering the United States at ports of entry and destined for FTZs are sealed by Customs and transported to the trade zones under "in-bond" status. Technically, this means that the sugar is not imported into the United States until it is placed into domestic commerce in the form of sugar-containing products made in the FTZ. At the FTZ the seal is to be broken by a Customs employee or, with Customs authorization, by the FTZ operator.

¹³TSUSA item 958.18, which sets a quota of 84,000 tons on products (with certain exceptions) under TSUSA item 183.05.

During a visit to one FTZ, we noted that the seal on a 132-ton shipment of sugar had been broken by the user and that the shipment was unloaded into the trade zone without the knowledge or approval of Customs or its authorized representative (the grantee). If the quantity of sugar shipped into an FTZ is not accounted for, sugar can be diverted before it reaches the FTZ, or a greater amount of sugar can be received in the FTZ than shown on the shipping documents. Either case would allow the user to dispose of commodity sugar in U.S. commerce before the sugar is charged against the applicable quota. In addition, contraband, including drugs, could be sealed in the shipments. After we brought this matter to the attention of Customs district officials, the district notified the FTZ operator that the delivery practice was contrary to Customs regulations and that future shipments would require prior Customs approval. In June 1988 Customs officials informed us that this deficiency was addressed in the May 31, 1988, servicewide directive.

Case 5: Unauthorized Sugar Has Been Diverted Into U.S. Commerce

According to Customs and company entry documents, one FTZ company, after reaching its 1986 sugar allocation, brought additional sugar into the zone, blended it with gelatin, shipped the blended product to a company in Canada, concomitantly purchased (under a different company name) the identical product from the same Canadian company, and brought the repurchased product back into the zone. Customs district officials, the grantee/operator, and the FTZ Board Executive Secretary believed that the FTZ company had discontinued operations when the company reached its sugar allocation level. In fact, in January 1987 the Customs District Director informed headquarters that the FTZ company had terminated operations on September 3, 1986, having used nearly all of its allocation for calendar year 1986. If an adequate system of control over incoming or outgoing merchandise had been in place, the zone operator, Customs, and the FTZ Board would have been alerted to the export and repurchase activities.

After reaching its allocation in early September, however, the FTZ company had continued production, entering almost 1,700 tons of sugar, which it blended into a gelatin mix.¹⁴ Customs district records show that 77 shipments of the blended product were exported to Canada between October 1986 and February 1987. The destination for the mix was the same Canadian sugar refiner that had supplied the refined sugar to the FTZ company and to other FTZ producers. District Customs officials were

¹⁴TSUSA item 182.90—Edible preparations not specially provided for (including prepared meals individually packaged), of gelatin.

unable to explain why a sugar refiner would purchase a gelatin mix. We were unsuccessful in our attempt to contact the president of the FTZ company to talk to him about the transaction.

Company entry documents showed that the same gelatin product was then shipped from the Canadian refinery to the same FTZ but billed to a different company name at the FTZ company president's private residence. Customs Service district records showed that the Canadian refiner shipped 84 truckloads of gelatin mix to the FTZ between October 1986 and February 1987. The FTZ operator's executive director told us that he was unaware of the shipments after September 1986.

According to Customs regulations, the shipment of merchandise abroad with the intention of returning it to the United States with a design to circumvent provisions of the TSUSA or to secure a benefit accruing to imported merchandise is not an exportation and therefore is not allowed. In this case company documents indicated the gelatin mix was trucked out of the country, subsequently returned to the FTZ, and trucked to an out-of-state food company. We estimate that as much as 1,500 tons of foreign sugar was blended with gelatin, exported to Canada, repurchased and reimported, and then sold to the out-of-state firm in 1986 in excess of the FTZ Board-authorized amount.

The zone operator and regional Customs officials, with whom we discussed this case a number of times between September 1987 and January 1988, told us that no sugar had been brought into the FTZ since July 1987, that no blending for export had occurred in 1987, and that as of January 1988 the FTZ company had discontinued operations. After our first September 1987 discussion, the regional Customs officials requested a Customs' Office of Enforcement investigation as to whether the FTZ producer had committed any criminal violations. As of May 1988 the investigation was ongoing, but Customs had already taken action to help prevent repetitions of this circumvention. Customs issued a new ruling, dated May 2, 1988, governing the export of sugar-containing products, which requires that such exportations be charged against the allocation in the same manner as when the products enter U.S. commerce. FTZ Board officials told us that the Board would not allow the company to resume operations pending the outcome of the Customs investigation.

Case 6: Duty-Free, Quota-Free Merchandise Should Be Periodically Sampled and Tested

We noted that a spot check at an FTZ had found a discrepancy between the TSUSA classification and a laboratory analysis of a product. If the laboratory analysis was correct, 20,000 tons of the product entered U.S. commerce quota and duty free when it should have been classified as a quantity controlled item;¹⁵ should not have been allowed into U.S. commerce because the applicable quota was filled; and, if allowed, would have been dutiable at 16 percent ad valorem. The Customs import specialist responsible for ensuring the accuracy of the merchandise classification told us that he had not accepted the laboratory results because he believed the laboratory was often in error and that on the basis of specific rulings and the advice of the National Import Specialist, he had allowed the company to import the product as described in its documents. He had not asked for additional tests of the product.

Customs headquarters informed us that the import specialist made a proper classification in this situation, but it also noted the need for periodic sampling and laboratory analysis of items entering under duty-free, quota-free tariff provisions. According to Customs, the need for periodic sampling and laboratory analysis of an item entered under duty-free, quota-free tariff provisions is obvious, and is not obviated by import specialists' experience or rulings. Customs said that with this in mind, its Office of Technical Services (which includes Customs' laboratory operations) and its Office of Trade Operations would draft a standard operating procedure to address this issue.

Case 7: Sugar-Blended Products May Have Originated in Country Subject to Import Restrictions

In at least one FTZ, some sugar had been received from Canada that had been grown in South Africa, which is subject to a U.S. embargo. The Comprehensive Anti-Apartheid Act of 1986 (P.L. 99-440, Oct. 2, 1986) prohibits the entry of agricultural products, including sugar, from South Africa. The act also prohibits the import of derivatives of sanctioned products or any product suitable for human consumption. An October 24, 1986, Customs ruling specifically stated that South African sugar may not be imported. However, in November 1986 Customs approved the entry of 20 lots, or an estimated 440 tons, of South African-grown, Canadian-refined sugar into one FTZ. Customs' rationale, as relayed to the FTZ grantee by a headquarters import specialist, was that raw sugar was substantially transformed during the refining process.

¹⁵TSUSA item 182.92—Edible preparations not specially provided for (including prepared meals individually packaged) containing over 5.5 percent by weight of butterfat and not packaged for retail sale.

A more recent Customs ruling, dated July 13, 1987, states that processing raw sugar into a refined product does not constitute a substantial transformation for tariff purposes, and a Customs compliance circular on South African sanctions, dated July 21, 1987, states that imports of prohibited goods transshipped through third countries are prohibited. The circular specifically lists sugar, syrups, and molasses as prohibited items. Also, an October 5, 1987, Customs ruling states that upgrading and packaging sugar in a second country to make it suitable for retail sale does not change the country of origin because the fundamental character of the product does not change. In December 1987 regional Customs officials told us that their position on Canadian-refined sugar had not changed. They said that they still considered cane or beet sugar refined in Canada to be of Canadian origin regardless of where the sugar-producing plant was grown.

In April 1988 Customs' Commercial Compliance Division officials told us that the regional office officials were incorrect. They said that the recent circulars and rulings have clarified that the country of origin is the country in which the sugar is grown. Because Canada grows only beet sugar, sugar only from Canada's three beet sugar factories is allowed to be entered against Canada's quota. Thus, cane sugar from Canada is now prohibited. Customs' May 31, 1988, directive reemphasized that the country that grew the imported refined cane sugar must be listed on the Customs entry form as the country of origin.

**Case 8: Paperwork
Controls Over Admission
of Merchandise Into Some
FTZs Were Not Always
Followed**

We found that Customs paperwork controls had not always been followed at some of the FTZs we visited. This could have led to misclassified merchandise, loss of revenues, and opportunities for a more aggressive user to circumvent sugar quotas.

Customs regulations and directives provide that merchandise may be admitted into a zone only upon (1) application on a uniquely and sequentially numbered Customs Form (CF) 214, "Application for Foreign Trade Zone Admissions and/or Status Designation," and (2) issuance of a permit by the district director.¹⁶ Although the audit-inspection program allows FTZ operators to admit merchandise into an FTZ without Customs' physical examination, the CF 214 must first be approved by Customs and then presented to the operator. In addition, the operators

¹⁶Customs regulations allow exceptions to the CF 214 requirement for merchandise temporarily deposited (19 C.F.R. 146.33), transiting merchandise (19 C.F.R. 146.34), and domestic merchandise admitted without permit (19 C.F.R. 146.43).

**Appendix V
Cases Involving Controls Over Sugar-
Containing Product Imports**

we talked with were authorized to break Customs seals on merchandise but only with an endorsed CF 214.

Some of the control problems we found prior to the implementation of the audit-inspection program in May 1986 in regard to CF 214s were as follows:

- Sugar was physically admitted into an FTZ before the broker (the agent who purchased the sugar for the FTZ company) applied for Customs approval and Customs granted authorization.
- Forms were not signed or forms were signed but not dated by the Customs admitting official.

These paperwork control problems indicated a laxness with respect to Customs' review of the paperwork used to control foreign sugar admitted into FTZs. In June 1988 a Customs official told us that Customs verified the control problems during regional surveys, corrected them, and covered the points in the May 31, 1988, servicewide directive and in training courses.

Administrative Options for Limiting Sugar-Containing Product Imports

The U.S. Customs Service has extensive regulations and procedures designed to control imports and is concerned about imports of all products that circumvent duties, quotas, or embargoes. In 1981 the Department of the Treasury amended Customs regulations relating to the examination of imported merchandise to allow Customs to physically examine only high-risk shipments, that is, those imports that are most likely to involve violations. Commodity sugar and sugar-containing product imports at ports of entry and through FTZs and subzones are subject to the amended regulations. However, only those imports classified under quota categories have been considered by Customs to be high risk. Sugar-containing product imports classified under nonquota categories have received low Customs priority. This has reduced the chances of identifying, correcting, or preventing situations in which the sugar import quota system can be circumvented.

We recognize that Customs is under resource constraints. Customs processed 6.8 million shipments during fiscal year 1985, a 56-percent increase over 1979, with about the same number of inspector positions. We also recognize that while Customs is responsible for insuring that imported merchandise complies with the trade laws of the U.S. government, including preventing the improper entry of goods and collecting revenues, it is also responsible for facilitating the flow of trade. Balancing these two often-conflicting responsibilities poses a difficult problem for Customs officials, particularly when importers try to get their shipments speedily approved before a quota limit is reached.

Customs import specialists we spoke with said that they believe importers are beginning to have a larger impact than in the past and that the result is a balance shift toward facilitating the flow of trade. They said that the pressure on import specialists is to decrease the use of sampling and laboratory testing, to quickly move paperwork submitted by importers even if it has not been fully verified, and to not spend a great deal of time categorizing imports. The price incentive for businesses to smuggle world-price sugar into the United States and the existing and potential situations we identified indicate that commodity sugar and sugar-containing products may require increased focus on Customs' responsibility to prevent the improper entry of goods and to collect revenues. We found that the level of independent inspections, testing, and verification may not have been sufficient to ensure that commodity sugar and sugar-containing product shipments comply with the various quotas, duties, and embargoes.

**Appendix VI
Administrative Options for Limiting Sugar-
Containing Product Imports**

Customs has taken some actions to improve its administration of FTZ Board sugar allocations and other enforcement mandates of the U.S. sugar program. On the basis of our findings, Customs issued a new ruling requiring that sugar exportations be charged against FTZ Board authorizations and plans to establish a system whereby duty-free, quota-free merchandise will be periodically sampled and analyzed. Customs has also clarified a number of positions relating to FTZ oversight in a servicewide May 31, 1988, directive.

In addition to having Customs monitor the implementation of its directive and other improvement actions, options available to the President to limit sugar-containing product imports include the following:

- Acting under section 22 of the Agricultural Adjustment Act of 1933, as amended (7 U.S.C. 624), to extend import restrictions, via import quotas or fees, to additional sugarcontaining products. Such an action should include a comprehensive analysis of all sugarcontaining products that carefully describes the products to avoid creating new loopholes.
- Submit a legislative proposal to rewrite tariff schedule descriptions so that existing loopholes can be closed while avoiding the creation of new loopholes.

Objectives, Scope, and Methodology

In a February 1987 letter, the Chairman and the Ranking Minority Member of the Subcommittee on Cotton, Rice, and Sugar, House Committee on Agriculture, asked us to determine whether circumventions of the sugar quota system were taking place. Specifically, the letter asked us to provide information on (1) the amount of sugar in sugar-containing product imports that displaces domestic sugar, (2) the increase in such sugar imports from 1982 to 1986, (3) the amount of sugar in sugar-containing product imports that enters U.S. commerce from FTZs and through ports of entry, (4) whether Customs controls over sugar-containing product imports have been adequate to ensure compliance with Customs laws and regulations, and (5) administrative options available to the President to limit the importation of sugar-containing products.

We made our review from March through November 1987 (with updates as appropriate through June 1988) mainly in Washington, D.C.; Chicago; and New York City. We met with and obtained information from federal officials involved in sugar program administration, including headquarters personnel at USDA's Foreign Agricultural Service, Economic Research Service, and Office of Inspector General; the U.S. Department of the Treasury's Customs Service, including its Commercial Compliance, Classification and Value, Technical Services, Inspection and Control, and Regulatory Audit Divisions; the Department of Commerce's Foreign Trade Zones Board and International Trade Administration; the U.S. International Trade Commission; and the Bureau of the Census. We visited Customs' regional and district offices in Chicago, regional office in New York, and district office in Detroit; Customs port offices in New York City and Toledo, Ohio; and Customs border facilities in Detroit, and Champlain, New York. We also visited, reviewed records, and met with managerial personnel of companies operating in FTZs in Chicago; Calumet Harbor, Illinois; Brooklyn, New York; and Toledo; a subzone in St. Charles, Illinois; and a bonded warehouse in Melrose Park, Illinois.

To obtain information on criteria, policies, and procedures, we reviewed legislation and regulations governing imports of commodity sugar (raw and refined) and sugar-containing products, including the Tariff Schedules of the United States Annotated, applicable sections of the Code of Federal Regulations, and Customs rulings and policy directives. To test, verify, and evaluate procedures and practices, we examined documents regarding the country of origin for commodity and sugar-containing product imports into the United States, nonquota sugar brought into FTZs, and blended sugar products exported from FTZs into U.S. commerce.

We also met with officials of trade groups, such as the National Confectioners Association and the U.S. Beet Sugar Association, to obtain industry views on federal sugar policies. In addition, we met with and analyzed data supplied by sugar experts within USDA, ITC, the consulting firm of Abel, Daft, and Earley, and Amstar Sugar Corporation in developing our estimates of imported sugar in sugar-containing products.

We did not quantify the amounts of sugar involved in each of the situations discussed in the report because of our limited staff resources and because in most cases we did not have access to the books and records of the companies engaged in FTZ blending operations or to those of the brokers involved. Our examples reflect "snapshots" of selected aspects of Customs controls and do not reflect the findings of a comprehensive review of Customs operations.

Our work was performed in accordance with generally accepted government auditing standards. We requested written comments from the Departments of Agriculture, Commerce, and the Treasury. Comments from USDA and the Department of Commerce are enclosed. (See apps. IX and X.) Comments from the Department of the Treasury were not provided. However, views of the U.S. Customs Service were obtained through agency officials, and they are discussed in the report.

Customs Servicewide Directive Dated May 31, 1988

POLICIES & PROCEDURES MANUAL	<h2 style="margin: 0;">CUSTOMS DIRECTIVE</h2>	DISTRIBUTION: See signature page NUMBER: 3210-24 ISSUE DATE: MAY 31, 1988
SUBJECT: Sugar Processing Operations in Foreign-Trade Zones		
REFERENCES: Executive Proclamations 4941, 5071, and 5294; Customs Directive 3280-05 dated May 16, 1986; TSUS Numbers 155.20, 155.30, 155.40, 155.75, 156.45, 183.01, 183.05, and 956.05 through 958.18		
<p>1. <u>PURPOSE</u></p> <p>To provide uniform servicewide instructions and guidance for proper supervision of storage and operations involving sugar and sugar-containing products in foreign-trade zones.</p>		
<p>2. <u>BACKGROUND</u></p> <p>Through Executive Proclamation 4941, the President imposed an absolute quota on the importation of raw and refined sugar in May 1982. To protect against circumvention of this quota, additional quotas were imposed on various imported products containing sugar under Executive Proclamations 5071 and 5294.</p> <p>The various quotas presented an opportunity for importers in foreign-trade zones to manufacture products not subject to quota using imported sugar. Some importers took advantage of this opportunity. To prevent further circumvention, the Foreign-Trade Zones Board has since 1986 prohibited most new FTZ manufacturing operations using sugar, and placed quantity limits on the production of the existing operations in Foreign-Trade Zones 1, 8, 22, 25, and 49.</p> <p>The Board has since approved two new foreign-trade subzones in Illinois and Wisconsin for the manufacture of sugar-containing products. However, the subzones are subject to the conditions that (1) they may only produce products subject to a quota, and (2) the zone grant must be reconsidered for renewal after 2 years in operation. At sometime in the future, the Board may consider approving new zones with the same or similar conditions.</p> <p>Another sugar program affecting foreign-trade zones is for sugar which is imported under USDA license for the purpose of reexportation in refined form or in sugar-containing products. Procedures for this program are covered by Customs Directive (CD) 3280-05. Under these procedures, products of sugar imported under USDA license may be considered exported in a foreign-trade zone <u>only</u> if they have been admitted in zone-restricted status.</p>		
<small>Customs Form 334C (11/88)</small>	 <p style="margin: 0; font-weight: bold; letter-spacing: 0.5em;">C U S T O M S I S S U A N C E S Y S T E M</p> <p style="margin: 0; font-size: small;">D E P A R T M E N T O F T H E T R E A S U R Y • U N I T E D S T A T E S C U S T O M S S E R V I C E</p>	

- 2 -

The variety of these programs and the number of Headquarters memoranda, telexes, and other instructions to implement them have led to some confusion in field offices. It is, therefore, desirable to combine the instructions into one Directive.

3. ACTION

A. GENERAL

- (1). Imported, duty paid, and domestic sugar may be brought into a foreign-trade zone for storage without charge to any quota. Fungible bulk sugar from different lots may be mixed together in storage under the FIFO accounting procedures of CD 3260-11 as applicable to foreign-trade zones and except as noted below.
- (2). Sugar which is admitted in zone-restricted status, such as export sugar provided for in CD 3280-05, may not be manufactured or manipulated in a zone. Neither may it be mixed with sugar in any other zone status under FIFO or any other approved inventory method.
- (3). No manufacturing of sugar-containing products will be approved without the prior approval of the Executive Secretary, Foreign-Trade Zones Board. A separate application will be required for each sugar-containing product to be manufactured in the zone. A copy of each permit on Customs Form (CF) 216 will be sent to the import specialist handling the product to assure that no entry is accepted for any product not approved for manufacture in the zone.
- (4). Customs officers should bear in mind that sugar and most sugar-containing products are subject to quota and are, therefore, restricted merchandise, for which there is a substantial incentive for smuggling or fraud. Therefore, they should take particular care to see that the merchandise is examined upon admission to a zone, as if it were being entered for consumption, as specified in CD 3210-15. The merchandise shall also be selectively examined upon entry for consumption, as provided in CD 3210-22.

CD 3210-24, May 31, 1988

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Enforcement examinations will also be periodically done on sugar and sugar-containing products entered in-bond for IE, VSIE, IT, T&E, and VST&E.

- (5). The country of origin of raw sugar which has been refined in Canada is not Canada, but rather the country of origin of the raw sugar. The true country of origin must be shown on Customs Form 214. Only beet sugar is grown in Canada and almost all of it is consumed in Canada. If Canada is claimed as the country of origin on Customs Form 214, selective samples shall be taken for laboratory analysis and determination as to whether the sugar was produced from beets or cane.
- (6). Sugar and sugar-containing products which are subject to quota are restricted merchandise. Therefore, they are not eligible for direct delivery to foreign-trade zones, as specified in Section 146.39(c)(1), Customs Regulations.
- (7). A weekly entry for estimated production under Section 146.63(c)(1), Customs Regulations, will not be accepted for any sugar or sugar-containing product which is subject to quota.
- (8). By agreement with the Foreign-Trade Zones Board, an annual report must be sent to Headquarters Office of Cargo Enforcement and Facilitation by each district director having responsibility for a zone where sugar-containing products are manufactured. The report is due in Headquarters each January 30, covering operations during the preceding calendar year. The report will show:
 - a. The types of sugar-using operations conducted in the zone, kind of materials used, and the percentage of sucrose content and the TSUSA Number of each of the products as transferred to Customs territory;
 - b. commercial use of each of the products as transferred to Customs territory;
 - c. total quantity, in pounds, of the sucrose content of manufactured products transferred to Customs territory for consumption or for transportation to another zone or port; and

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- d. total quantity, in pounds, of the sucrose content of manufactured products transferred to Customs territory for exportation or transportation and exportation.

B. SUGAR OPERATIONS WITH FTZ BOARD QUANTITY LIMITS

- (1). Each district where the Board has authorized continued operations under quantity limits has been advised individually of the amount of the limit for specific importers. The limit will remain the same from year-to-year unless specifically changed by the Board, through a notification from Headquarters. The amount of the quantity limit, the identity of the permittee, and the quantity admitted, produced, and transferred from the zone by the permittee are all to be treated as exempt from disclosure under 5 U.S.C. 552(b)(4).
- (2). The quantity limit applies to the amount of sugar contained (the sucrose content) in all sugar-containing products transferred from the zone for consumption, exportation, or any other disposition during a calendar year. However, the Board may increase the quantity limit by a specified amount solely for exportation or transportation and exportation under a special program authorized by the Board. If this is done, the basic quantity limit will apply to the sucrose content of all sugar-containing products transferred from the zone, except those covered by the special export program.
- (3). The district director will establish and maintain a program to track, on a continuing basis, the quantity of sugar contained in products for consumption, exportation, and other purposes, as required by the annual report. Another program will be established and maintained to track the sugar contained in products under a special export program. If the quantity of sugar transferred from the zone reaches 90 percent of the FTZ Board quantity limit on or before November 30, a written report or telex will be sent to Headquarters Office of Cargo Enforcement and Facilitation for notification to the Foreign-Trade Zones Board.

CD 3210-24, May 31, 1988

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- (4). If the quantity of sugar transferred from the zone reaches the FTZ Board limit, no additional transfers will be permitted from the zone. Any removals beyond the limit without Customs permit will be treated as a default involving merchandise under Section 113.73(a)(2), Customs Regulations.

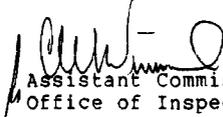
C. SUGAR OPERATIONS SUBJECT TO FOREIGN-TRADE ZONE GRANT CONDITIONS

- (1). Sugar operations in this category are not subject to an aggregate limit on all transfers. Rather, they are subject to the quantitative limits of the applicable quota for merchandise entered for consumption. There is no limit on the quantity of sugar or sugar-containing products that may be exported from these zones. Because of the potential for quota circumvention, however, district directors will take care to see that the provisions of Section 146.62(b)(2), Customs Regulations, are followed for in-bond movements for IT and T&E.
- (2). The general intent of the zone grant is to limit production to products subject to a quota. However, the zone importer may manufacture and enter for consumption products which are not subject to quota if they were manufactured from sugar in privileged foreign status. In this case, the sugar contained in the product will be subject to the quota under TSUS Number 155.20 or 155.30.
- (3). The importer may also elect to manufacture non-quota products from domestic status sugar (U.S. origin or duty-paid but not zone-restricted status). In this case, the product may be transferred to Customs territory without charge to any sugar or sugar-product quota.
- (4). Because of these options, district directors should take care to see that the inventory procedures adopted by the zone operator for sugar in more than one zone status do not result in circumvention of any applicable quota.

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4. RESPONSIBILITIES

District directors shall see that the provisions of this Directive are carried out, and that applicable zone grantees and operators in their area of jurisdiction are informed of its contents. Regional commissioners shall see that this Directive is carried out uniformly and effectively throughout their respective regions.


Assistant Commissioner
Office of Inspection and Control

Distribution:
R-01 Regional Commissioners
F-01 District/Area Directors
F-02 Port Directors

Comments From the U.S. Department of Agriculture

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



United States
Department of
Agriculture

Foreign
Agricultural
Service

Washington, D. C.
20250

JUN 2 1988

Mr. Brian P. Crowley
Senior Associate Director
Resources, Community, and Economic
Development Division
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Crowley:

We appreciate this opportunity to provide you the Department of Agriculture's comments on the United States General Accounting Office Draft Report entitled "Sugar Program: Issues Related to Imports of Sugar-Containing Products."

We have enclosed comments on the report provided by various agencies of the Department of Agriculture. Technical corrections to the report have already been developed in interactions between staff of the Foreign Agricultural Service and the General Accounting Office.

The report provides useful insight into the complexities surrounding this issue. It is clear that the main barrier to reaching consensus on the amount of sugar and sweeteners being imported in products is the wide variability in the number of imported products used in estimating this amount, as reflected on page 54 of the Draft Report. The variability in the number of products used in making such estimates revolves around the central question of what individuals are in fact trying to estimate. Some are trying to estimate how much domestic raw and refined sugar consumption is displaced by imports of sugar in products while others are trying to estimate how much sugar and sweetener in total is imported in products. The former type of estimate in most cases is derived from a smaller number and volume of products than the latter type of estimate.

The Department of Agriculture has not made an estimate of how much raw and refined sugar consumption is displaced by imports of sugar in products but we have estimated how much sugar and sweetener in total is imported in products. We have enclosed for your information a copy of this estimate. It was prepared by the Foreign Agricultural Service. This estimate provides a good assessment of how much sugar and sweetener is imported in products but in no way should be taken as an estimate of displaced domestic sugar consumption.

Sincerely,

THOMAS O. KAY
Administrator

Enclosures

Now on p. 45.

See comment 1.



United States
Department of
Agriculture

Economic
Research
Service

Washington, D.C.
20005-4788

May 19, 1988

SUBJECT: Review and Comment on GAO report, Sugar Program:
Issues Related to Sugar-Containing Products

TO: Richard Finkbeiner
Foreign Agricultural Service

The GAO report is a useful contribution to our present knowledge of imports of sugar-containing products, the operation of foreign trade zones, and the vulnerability of the U.S. sugar program to attempts at circumvention. Technical corrections and editorial comments are indicated in the text (see attached pages). Major points:

1. Page 24. Need to clearly distinguish between U.S. manufacturers of sugar-containing products (the industrial users of sugar), and U.S. consumers of sugar-containing products which can be either imported or domestically manufactured.

2. Page 28. Need to clearly distinguish between "import quota", and "quota imports". Quota imports (synonymous with "sugar under quota") incorporates sugar imported under one or more designated import quota periods.

3. Pages 31, 74, 75. Need to clarify whether importation of blends or products containing sugar from countries whose sugar is banned in the United States, breaks the letter of the law as well as the spirit of the law.

4. Page 33. CCC's loss on 1984-crop sugar loan defaults (in 1985) totaled not \$83 but \$89.9 million. The cost excludes CCC's \$17.5 million payments to growers to compensate for damages when the Great Western Sugar Co. went bankrupt.

5. Page 54, 55. Just to clarify matters, the "USDA estimate" of 950,000 tons of sugar in imported products in 1986 is really the FAS Sugar Group's estimate not ERS's. ERS did not apply an across-the-board 50-percent-sugar-content rule for all items but, instead, estimated the sugar content for major individual items. Instead of an increase of 580,000 tons (from 370,000 tons in 1982 to 950,000 tons in 1986), ERS estimated an increase of 300,000 tons. This, in fact, turns out to be close to the middle of the 250,000 to 430,000 tons range eventually estimated by GAO. ERS agreed to the FAS estimate because it seemed within the range of possibility, albeit at the maximum of possibilities.

6. Page 56. "Animal feeds" would appear to provide an avenue for circumvention of the sugar program as illustrated by Abel, Daft & Earley (May 12, 1988 report, attached).

See comment 2.

Now on pp. 30 and 65.

Now on p. 32.

Now on pp. 49 and 50.

Now on p. 51.
See comment 3.

Appendix IX
Comments From the U.S. Department
of Agriculture

Now on p. 54.

Now on p. 37.
See comment 4.

7. Page 59. The chart showing sugar import flows needs to be double-checked for completeness and accuracy. For example, it shows "52,400-ton sugar limit" but it is not clear where the number comes from in the text; instead, page 40 cites a 55,000-ton limit. Also, perhaps the chart should distinguish between the grandfathered foreign trade zone (as shown on chart) and the subzones which are permitted to operate only for the manufacture of products subject to the 84,000-, 7,000-, and 3,000-ton quotas (edible preparations, pancake flour/mixes, and sweetened cocoa, respectively).



B. H. Robinson
Associate Administrator

Appendix IX
Comments From the U.S. Department
of Agriculture



United States
Department of
Agriculture

Agricultural
Stabilization and
Conservation Service

P.O. Box 2415
Washington, D.C.
20013

MAY 20 1988

SUBJECT: ASCS Comments on GAO Draft Report,
"SUGAR PROGRAM: Issues Related to
Imports of Sugar-Containing Products"

TO: Richard Finkbeiner
Director, Compliance Review Staff
Foreign Agricultural Service

A thorough review was made of the subject draft report. The purpose of this report was to review certain aspects of the U.S. sugar program to determine whether circumventions of the sugar quota system were taking place.

ASCS has no comments pertaining to the findings and options designed to reduce or prevent circumventions of the sugar quota which are contained in this report. This agency is primarily concerned with the administration of the domestic sugar price support loan program. However, there are several technical errors pertaining to the price support program which should be corrected in the final draft report. Corrections need to be made on pages 3, 4, 32, 33 and 34. Copies of pages 3, 4, 32 and 34 are enclosed with our edits. Page 33 needed extensive revision, so a proposed rewrite is enclosed.

Please keep this Agency advised of the responses and/or actions recommended by other Agencies within USDA and other Departments.

Milton J. Hertz
Milton J. Hertz

Administrator

Enclosures



See comment 5.

Now on pp. 3, 4, 31, and 32.

The following are GAO's comments on the U.S. Department of Agriculture's letters dated June 2, May 19, and May 20, 1988.

GAO Comments

1. The Department's estimate is discussed in appendix IV. The copy of the estimate enclosed in USDA's letter is not reproduced herein.
2. The technical corrections and editorial comments are not reproduced herein. The suggested changes have been made in the report as appropriate.
3. As discussed in appendix IV, we did not include some products, including animal feeds, in our estimate of the amount of sugar imported in sugar-containing products because some of the experts we spoke with did not consider these products to be ones that directly displace domestic cane or beet sugar.
4. We deleted the number from figure V.I because the quota changes from year-to-year depending on the number of active FTZ sugar-blending operations.
5. The technical corrections are not reproduced herein. The suggested changes have been made in the report as appropriate.

Comments From the U.S. Department of Commerce



UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for International Trade
Washington, D.C. 20230

MAY 31 1988

Mr. Brian P. Crowley
Senior Associate Director
Resources, Community, and
Economic Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Crowley:

Thank you for inviting our comments on a draft of the report your agency is preparing on sugar-product imports.

The draft has been reviewed within the International Trade Administration, and we have discussed some minor editorial points with your staff. We have noted with concern the control issues you have cited. Although some of them apparently have already been addressed by the U.S. Customs Service, we plan to cooperate fully with Customs in taking appropriate action with respect to any unresolved problems that are noted in the final report.

Your report and the position of Customs on control issues will have an effect on whether and to what extent the Foreign-Trade Zones Board allows the grandfathered sugar blending operations to continue in foreign-trade zones. Your final report will be given our full and immediate attention.

Sincerely,

A handwritten signature in cursive script, appearing to read "Allen Moore".

Allen Moore (Acting)



Major Contributors to This Report

Resources,
Community, and
Economic
Development Division,
Washington, D.C.

Brian P. Crowley, Senior Associate Director, (202) 275-5138
William E. Gahr, Associate Director
Andrew E. Finkel, Evaluator-in-Charge
Patricia A. Yorkman, Evaluator
Sandra M. Emrick, Computer Programmer
Elizabeth T. Morrison, Writer-Editor
Frances D. Williams, Secretary/Stenographer

Chicago Regional
Office

Melvin J. Koenigs, Regional Assignment Manager
Ralph Deitz, Evaluator

New York Regional
Office

Bernard D. Rashes, Regional Assignment Manager
Despina Hatzelis, Evaluator
Ernest J. Arciello, Evaluator

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