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JULY 17, 1979

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The Honorable Richard Nolan
House of Representatives

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Dear Mr. Nolan:

Your letter of April 9, 1979, requested that we evaluate whether the April 1, 1979, reduction in the U.S. import fee on sugar was justified and answer several questions about the administration of the import fee mechanism.

Our review was conducted in Washington, D.C., and in New York and London. We interviewed and obtained documentation from U.S. Government officials, firms, associations, and organizations involved in the world trade of sugar.

As arranged with your office, we plan no further distribution of this report until five days from the date of the report. At that time we will send copies to interested parties and make copies available to other persons upon request.

IMPORT FEE ON SUGAR

price supports

Section 902 of Public Law 95-113, the Food and Agriculture Act of 1977, provides that the price of processed products from the 1977 and 1978 sugarbeet and sugarcane crops shall be supported through loans or purchases at a level that would not be less than 13.5 cents a pound for raw sugar. Effective January 1, 1979, the administration began supporting the price of sugar at 15 cents a pound, raw value, for the remainder of the 1978 crop year.

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On December 28, 1978, the President, in Proclamation 4631, noted that sugars were being imported, or were practically certain to be imported, into the United States under such conditions and in such quantities as to render or tend to render ineffective, or to materially interfere with, the Department of Agriculture's sugar price support operations. Using the authority vested in him by Section 22 of the Agricultural Adjustment Act, as amended (7 U.S.C. 624), the President provided for a quarterly adjustment fee designed to raise the price of imported sugar to 15 cents.

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The Proclamation sets a fee adjustment period for each quarter. The quarterly adjusted fee is the amount which would bring the average daily spot (world) price quotations for raw sugar during the adjustment period (as reported by the New York Coffee and Sugar Exchange or, if such quotations are not being reported, by the International Sugar Organization) to 15 cents a pound after adding U.S. applicable duty and attributed costs of 0.90 cents a pound for freight, insurance, stevedoring, financing, weighing, and sampling. On January 1, 1979, this fee was established at 3.35 cents a pound.

The Proclamation also contains a second fee-adjustment provision. When the average daily spot price quotations for 10 consecutive market days within any calendar quarter, adjusted to a U.S.-delivered basis, plus the fee then in effect (1) exceeds 16 cents, the fee then in effect shall be decreased by one cent or (2) is less than 14 cents, the fee then in effect shall be increased by one cent. The fee, in any event, may not be greater than 50 percent of the average daily world price quotations for raw sugar.

New York spot price

The New York Coffee and Sugar Exchange, Inc., operates a commodity futures exchange through which approximately 300 members trade in raw cane sugar and other commodity futures. Prior to November 3, 1977, the Exchange, under its bylaws and rules, maintained a spot domestic sugar quotation committee and a spot world sugar quotation committee. Each committee, consisting of five members of the Exchange, determined daily spot prices for raw sugar sold in the domestic and world markets. The world committee was composed of five raw sugar merchants. On every trading day, these members, through the committee chairman, would discuss with each other by telephone the setting of the spot price for that day. After a majority agreement was achieved, the spot price was relayed to the Exchange and publicly announced.

Unlike for other commodities, there has never been a central U.S. market place for the purchase and sale of raw sugar to determine a true cash price. Usually, the world spot price was set on the collective and consensual discretion and judgment of the members of each committee, taking into account any reported purchases of physical sugar.

Foreign and domestic sugar growers, processors, and merchants often sold raw sugar under contracts which set the price by reference to an average spot price for a designated period.

Regulatory hearings

The Commodity Futures Trading Commission (CFTC) was created by the Commodity Futures Trading Commission Act of 1974 (7 U.S.C. 4(a)) to regulate commodity futures markets. In February 1977, the CFTC, under its general authority to regulate activity on the Exchange, 1/ held hearings focused on the two spot price committees of the Exchange to study their rules and practices.

As a result of its inquiry, the CFTC staff concluded that the operating procedures of the two spot committees were deficient with respect to the magnitude and manner in which discretion was used. The deficiencies included the apparent composition of the committees, the price discovery and quotation process, recordkeeping, and dissemination of information. It was concluded that the absence of effective reporting requirements by Exchange members for transactions in raw sugar and the absence of effective written guidelines for the committees' operating procedures contributed to these deficiencies. Recommendations were made to the Commission by the CFTC's Office of the Chief Economist in an attempt to mitigate the perceived problems with the committees' operating procedures.

Antitrust complaint

On October 17, 1977, the Government filed a civil antitrust suit against the New York Coffee and Sugar Exchange, Inc., alleging that it had conspired to violate Section 1 of the Sherman Antitrust Act (15 U.S.C. 1) through its determination and publication of daily spot prices for raw sugar. In its complaint, the Government asked the court to declare the Exchange's method for determining spot prices illegal and to prohibit the Exchange from continuing, maintaining, or renewing the method or any other method having a similar illegal purpose or effect. On November 3, 1977, the Exchange, although disagreeing with the complaint, voluntarily discontinued determining and publishing daily spot prices.

1/In a letter to CFTC dated May 25, 1977, the Department of Justice concluded that CFTC has no jurisdiction to impose regulations on cash marketing or cash price reporting, whether carried on by a futures market or otherwise.

On December 15, 1978, a proposed consent judgment was entered into by the Government and the Exchange. This consent judgment would permit the Exchange to determine and publish spot prices for raw sugar in accordance with a specific method consistent with antitrust laws and not inherently anticompetitive.

As provided by the Antitrust Procedures and Penalties Act (15 U.S.C. 16), any person wishing to comment upon the proposed judgment could do so within 60 days of publication in the Federal Register on December 27, 1978.

On February 23, 1979, the CFTC commented on the proposed judgment. The CFTC stated that as an independent agent its authority and responsibility were not and as a matter of law could not be affected by the agreement between the Department of Justice and the Exchange. On April 27, the Department of Justice's Antitrust Division replied to CFTC that the entry of the proposed decree would be consistent with the provisions of the Commodity Exchange Act and would not impinge on the Commission's regulatory authority.

Both the Commission's comments and the Government's response were filed with the court on April 27, 1979, and both were published in the Federal Register. On May 15, 1979, the court entered the consent judgment.

The final judgment sets forth the terms and conditions under which the Exchange may determine and publish spot quotations or prices of raw sugar. For the world spot quotation or price, the Exchange is to establish a roster of individuals knowledgeable in raw sugar trading, with four categories of individuals associated with (1) raw sugar merchants or operators, (2) sugar refiners, (3) industrial users, and (4) commission houses. On each trading day, an employee of the Exchange--who is not associated with any firm active at any level of the sugar industry--shall select by lot the names of four individuals from each roster category and one individual at large. Each day the Exchange employee shall telephone each of the individuals selected by lot and ask for a figure representing his expert opinion of that day's price differential between the f.o.b. price and the price of raw sugar under the world sugar futures contract for the nearest delivery month then trading on the Exchange.

None of the individuals selected shall be informed of the identities of nor the figures furnished by other individuals selected or the ranges or averages of such figures.

As soon as possible after the close of the futures market for that day, the employee will compute the world spot quotation by eliminating the highest and lowest figures, averaging the remaining three figures, and adding that average to or substracting it from the weighted average price of all that day's transaction on the Exchange in the nearest delivery month of the world sugar futures contract then open for trading. The resulting amount will constitute the world spot quotation or price for that day.

On February 9, 1979, the Exchange submitted to CFTC for approval the proposed system for reporting raw sugar spot prices.

The world price

In the absence of the publication of a world spot price by the Exchange, Presidential Proclamation 4631 provides that the quarterly adjustment to the import fee will be based on the 20-day average price reported by the International Sugar Organization, which administers the International Sugar Agreement. The Agreement's world price is a simple average of the world spot price of the Exchange (when available) and a derived price based on the London Daily Price. If the Exchange world spot price is not available, the world price under the Agreement is derived from the London Daily Price alone.

The International Sugar Agreement world price, like the Exchange world price, is quoted in U.S. cents per pound of sugar f.o.b. and stowed in the Caribbean. The London Daily Price is published as pound sterling per metric ton c.i.f. (cost, insurance, and freight) to the United Kingdom. To derive an equivalent International Sugar Agreement world price, it is necessary to subtract a freight factor (which on May 10, 1979, was established at 13.50 pound sterling per metric ton) and convert from pound sterling per metric ton to cents per pound based on the current rate of exchange.

The London Daily Price

The London Daily Price is established by the price committee of the London Terminal Sugar Market Association, which, like the Exchange, is engaged in operating a commodity futures exchange. The price committee is an informal self-regulating group of five sugar merchant or brokerage firms and exists on the basis of market acceptance of the London Daily Price. Although the Bank of England monitors the

Association, mainly from a foreign exchange interest, there is no formal regulation, such as CFTC's regulation over the New York Coffee and Sugar Exchange. Other comparisons noted between the spot price committees of the Exchange and the Association are that:

--The Exchange world spot committee established general written guidelines, approved by the Exchange, which identified those types of transactions that the committee members may consider in determining a spot quotation. There are no such procedures for the Association price committee.

--The Exchange world spot committee arrives at a consensus by telephone, whereas the Association price committee physically meets.

Since the Association price committee, in its deliberations, relies on reported physical trades in the world market, it is using the same information as the Exchange world spot committee used. However, as there are few reported fixed-price quotations for physical sugar in the world market, both committees mostly set spot quotations on the basis of personal discretion and judgment, known as the tone of the market. Tone may be used also when there are fixed-price physical transactions which for some reason are considered not representative of the sugar market.

Basis for April 1979 fee adjustment

The April 1, 1979, fee adjustment was based on the average of the daily International Sugar Agreement world prices for February 20 through March 20, 1979. Before, during and after this period there was significant movement in the world price.

During the week of February 5th, the world price began to rise and surpassed 8 cents a pound by week's end. During the weeks of February 12 and 19 the rise continued, and on February 26 it reached the yearly high of 8.94 cents a pound. During this 2-week period, a number of large purchases of physical sugar were reported in trade publications at prices over the world price. In addition, there were favorable announcements from Washington regarding the prospects of domestic sugar legislation.

Between February 26 and March 2, trade publications reported several sales at prices lower than the world price, and the world price fell to 8.39 cents a pound on March 2. The week of March 5 started on the down side, with higher price sales reported during the middle and end of the week. On March 9th, the world price had risen to 8.55 cents a pound.

From that date until the beginning of April, few transactions in physical sugar were reported and the world price remained in the 8.50-cent range. During this period, the trade anticipated a reduction in the import fee. It was also anticipated that large amounts of sugar would arrive in the United States after April 1, which would decrease interest in buying and depress the price. 1/ By April 11, 1979, the world price had fallen to 7.81 cents a pound, near the average for the 20-day period prior to the fee-setting period.

The 20-day average price for the fee adjustment period was 8.54 cents a pound. On April 1, 1979, the import fee was reduced by 0.59 cents, based on a higher 20-day average world price than during the measurement period for the previous quarter.

ADMINISTRATION OF THE IMPORT FEE MECHANISM

Below are our responses to questions raised in your letter of April 9, 1979, based on information appearing above.

1. Was the reduction in fee justified and was the administration negligent in failing to investigate the apparent abuse of the London price determination as a basis for adjusting the fees?

In November 1977, the New York Coffee and Sugar Exchange ceased publication of a world spot price. In the absence of this price, the administration chose to use for fee-setting purposes the International Sugar Agreement world price, derived from the London Daily Price. As the Presidential Proclamation specifies the use of the International Sugar Agreement price, the April 1, 1979, fee reduction was not only justified but, in the absence of a change in the Proclamation, mandatory.

The London Daily Price is generally accepted as a reflection of the price of raw sugar in the world market. We believe

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1/During the 4-week period ending April 20, U.S. Customs records showed 420,243 tons of sugar imports compared with 255,652 tons for the 4-week period ending March 30, 1979.

that, had the Exchange's world spot price been published during the 20-day marketing period prior to April 1, 1979, the outcome would have been similar, as it would have been influenced by the same market information as was the London Daily Price and would have been derived by basically the same process.

Since there are few reported transactions in physical sugar at fixed prices, the ascertainment of a spot price is based primarily on the judgment and discretion of those persons involved in determining the price. We noted that, before and during the 20-day measurement period for setting the fee, the world price quotation appeared to reflect the price movement of physical sugar transactions reported in trade publications. Information is not available that would allow us to evaluate the underlying price movement and whether it was connected with the prospect of a downward adjustment in the import fee.

Although the International Sugar Agreement world price appears to be a fair reflection of the market, we believe that in light of the Department of Justice's antitrust action, the use of the world prices derived from the London Daily Price as the basis for establishing the average price during the 20-day fee-setting period could be viewed as inconsistent.

The Department of Justice, in filing the action, contended that the Government did not necessarily intend to challenge the concept of spot prices regardless of how they were determined or established. Rather, the Government specifically attacked the particular method by which the New York Coffee and Sugar Exchange set its spot prices. The Government believes, among other things, that the determination of spot prices solely on the basis of agreement and consensus among representatives of competing and self-interested firms constitutes illegal price tampering and is so inherently anticompetitive as to violate Section 1 of the Sherman Antitrust Act.

In view of this contention of the Government, as expressed by the Department of Justice, we question the selection by the administration of a pricing mechanism to establish the import fee that operates under less structure and regulation than did the mechanism for establishing and reporting the world spot price of the Exchange. In the absence of an Exchange world spot price, the alternative to relying on the London Daily Price would have been a price based on the near futures price.

2. If the London transactions do not accurately represent world sugar prices, what statutory responsibility does the administration have to raise the fees on imported sugar in order to protect the domestic sugar price support program?

The President has no obligation to raise the fee if it is determined that the London Daily Price does not accurately reflect the world price. Should the President desire to raise the fee, Section 22 of the Agricultural Adjustment Act, as amended, details the appropriate procedures and determinants attached to any administrative action.

To raise the fee, an investigation would have to be made by the International Trade Commission to determine whether the domestic support program was being rendered ineffective by the fact that the fees were being based on the purportedly inaccurate London market. The President could initiate such an investigation in this case. The only means of avoiding a prior investigation would be for the President to take immediate action under emergency conditions and raise the fee (7 U.S. C. 624(a)). A subsequent investigation by the Commission would have to be made, however, to substantiate the findings necessary to impose higher import fees. To support either a modification or cancellation of the Proclamation, it must be determined that (1) current sugar imports are threatening the domestic price support program and (2) the imposition of a higher fee or the cancellation of the present fee is necessary to maintain the effectiveness of the price support program.

3. What would be a more accurate gauge of world sugar prices?

Because of the limited number of fixed price transactions for physical sugar, any available system would depend on the judgment and discretion of knowledgeable persons to determine a spot or cash price. The new system agreed to between the Department of Justice and the New York Coffee and Sugar Exchange will depend on the judgment of selected persons estimating a price differential between the cash market price of world sugar and the price of sugar under world sugar futures contracts.

The proposed system, although not an exact measure of world prices, will eliminate the practices that the Department of Justice found objectionable in the system used previously by the Exchange for determining the world spot price. The Exchange anticipates that it will resume publication of a world spot price during July 1979, in which case it will be available for the 20-day measurement period prior to the October 1, 1979, fee adjustment date.

Although it will take several months of evaluation for the new method to obtain acceptance in the trade, the Proclamation requires that it be used, if available, for the computation of the import fee. During the initial months of publication, we believe the administration should monitor the method's performance and the reasonableness of using it as the basis for subsequent adjustments to the import fee.

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To expedite the issuance of this letter, your office requested that formal comments not be obtained. However, the letter has been discussed with representatives of the Departments of State and Agriculture, and their comments were considered. No substantial objections were raised.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States