

# **Module 4**

## **Export Subsidy Provisions in the Agreement on Agriculture (AoA)**

### **Introduction**

The primary instrument for multilateral regulation of international agricultural trade relations is the General Agreement on Tariffs and Trade (GATT). A number of the perceived weaknesses of the original GATT Agreements with respect to agriculture trade were addressed in the Agreement on Agriculture, contained in Annex 1 to the 1994 Agreement Establishing the World Trade Organization (WTO). The goal of the Agreement on Agriculture (AoA) is to reduce current and future use of trade-distorting policies and move towards freer agricultural markets in accordance with the organizing principles of the WTO. Three distinct types of trade distorting policies that impact agricultural markets are addressed in separate provisions of the AoA: restricted market access, export subsidies, and domestic support. This section will highlight the export subsidy provisions of the AoA.

### **Objective**

After completing this section you should understand the export subsidy provisions of the World Trade Organization (WTO) AoA and how they impact global agricultural trade.

Some key concepts to be covered in this section are:

- The definition of an export subsidy
- How much countries in the WTO have agreed to reduce export subsidies under the AoA
- Some economic consequences of export subsidies for exporting and importing countries
- Why U.S. producers care about export subsidies here and abroad

## Section 1 -What Are Export Subsidies?

### *Objectives*

In this section you will learn about

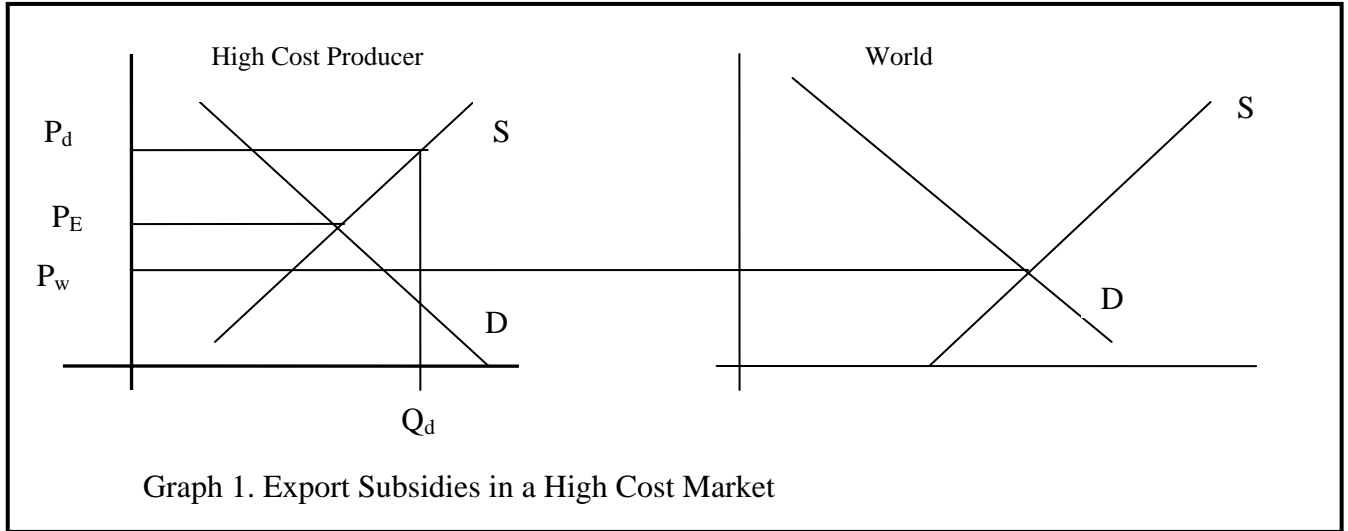
- how export subsidies work
- how export subsidies effect trade
- and, examples of some types of export subsidies.

### *Introduction*

*Export subsidies* are payments countries make to domestic producers that essentially lower the price of their products that are then sold in world markets. Export subsidies make products which cost more to make in some countries competitive with products made by other low-cost countries. For example, rice production in Japan is relatively expensive when compared to production in the Phillipines because Japanese producers must pay more for inputs including higher land costs, and demand a higher standard of living. The Japanese government has made a commitment to maintaining a certain amount of rice production in their country and one way to ensure the viability of farmers is to pay them the difference between the higher Japanese market price for rice and the lower world price. Japanese producers can then export their product at the lower world price. Numerous examples of high cost production can be found here in the U.S., as well in many other developed countries.

### *Export Subsidies – A graphical example*

Another way to think about export subsidies is illustrated in Graph 1. In Graph 1, we have equilibrium supply and demand conditions for a commodity in a high cost domestic market (S and D). These lines represent the amount producers are willing to produce at a point in time at a particular price ( $P_E$ ) in the domestic market. In the presence of support policies which raise the price of the product to  $P_d$ , producers supply much more of the product than the domestic market can absorb ( $Q_d$ ). In order to be competitive at the world price ( $P_w$ ), producers in the high cost country need to either lower costs, reduce production, or receive an export subsidy ( $P_d - P_w$ ), as indicated in the graph.



***How much have countries agreed to reduce export subsidies under the WTO AoA?***

Export subsidy provisions in the AoA banned the creation of new export subsidies and committed countries to reducing existing export subsidies over a period of time. Export subsidies were specifically defined for the purposes of this provision as:

- payments-in-kind
- export subsidies funded by producers
- transportation subsidies for exports
- subsidies for export marketing costs
- subsidies on products that are used to produce items which are then exported.

The base period for defining export subsidy levels was set as 1986 to 1990. Member countries committed to reducing subsidy levels by 36 percent over a six year period following the agreement. In addition, the countries committed to reducing the volume of subsidized exports by 21 percent for 22 unique products as defined by the AoA.

***Conclusion***

In this section you have learned about export subsidies, how they effect domestic and world prices for a commodity, and by how much member countries of the WTO committed to reduce export subsidies following the AoA. We know that export subsidies are paid to producers to help make them competitive on the world market, especially when they are competing with countries who can produce at a lower cost. Export subsidies can depress the price of a good on the world market at the expense of taxpayers in the subsidizing country, and producers in competing countries. The AoA banned the creation of new export subsidies and required that countries commit to reduce their current subsidy levels over the six year implementation period.

***Key Terms***

**Export subsidies** - are payments countries make to domestic producers that essentially lower the price of their products that are sold on the world market

***Quiz***

1. You are the lowest cost producer of corn in the world. Your major competitor, China, has just introduced an export subsidy for its producers. Do you support this subsidy?

Yes or No (answer No).

2. WTO member countries are committed to reducing subsidy levels by \_\_\_\_ percent over a six year period following the agreement.

a. 20%

b. 36%

c. 15%

Answer b.

## Section 2 -Economic Consequences of Export Subsidies

### *Objectives*

In this section you will learn about

- the effects of export subsidies on all trading partners
- some levels of export subsidization among WTO member countries
- and, the effects of some export subsidies in the U.S. market for agricultural goods.

### *Introduction*

Export subsidies have consequences for many players in the global markets, and usually these effects are the opposite for producers and consumers. For exporting countries that pay subsidies, producer incomes are increased at the expense of consumers in the country since they pay taxes to fund domestic support provided for producers. In addition, depending on the amount the country protects its markets from imports, consumers may incur an additional “tax” as they must pay a higher price for the good than what they might pay if imports were allowed.

### *Effects of export subsidies on importers and exporters*

In the case of importing countries, it is useful to think of two types of countries; first, countries that produce the product that is being subsidized, and second, countries that are unable to produce the subsidized product. In the first case, export subsidies tend to depress world prices for the commodity since the subsidized producers supply more product to the market than they would if the subsidy were not in place. Subsidies reduce export earnings for other countries and cut into their global market share. In the second case, consumers in importing countries that cannot produce the subsidized product gain since they are able to buy the product at a lower price.

### *Export Subsidies by Country and Commodity*

Looking at Table 1 below, it is easy to see that the EU is by far the largest subsidizer of agricultural exports in the world market. The U.S. pays out the second highest amount of export subsidies, however, this amount is dwarfed by the EU number. All developed countries participating in the WTO have agreed to continue reducing export subsidies to producers. Developed and developing countries alike argue that the high levels of total subsidization (domestic support and export subsidization), mainly by the EU, U.S., and Japan, of agricultural products cause significant distortion in the world market and steps need to be taken to further reduce these high levels of support.

<b>Country</b>	<b>European Union</b>	<b>United States</b>	<b>Rest of World</b>	<b>Total</b>
<b>1995</b>	6496	26	264	7324
<b>1996</b>	7071	122	223	7886
<b>1997</b>	4857	112	192	5555
<b>1998</b>	5989	147	162	6668
<b>1999</b>	5854	80	175	6504
<b>2000 1/</b>	2517	15	140	2903

<b>2001 1/</b>	2297	55	41	2425
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Source: USDA-ERS available at [www.ers.usda.gov/db/wto/](http://www.ers.usda.gov/db/wto/)

### ***Effects of export subsidies on the U.S. market***

Why should the U.S. care if the EU has such a high rate of export subsidization? Because the U.S. is a major importer of products which compete with domestically produced goods. In 2000, the U.S. was the second largest importer of agricultural products in the world, importing \$40.5 billion worth of goods. U.S. producers of agricultural products, especially if they are exported, should be concerned about levels of export subsidies in foreign countries. For example, during the 1990s, over 11 percent of total fruit and tree nut production was exported. Of all categories, dried fruits were most export dependent with over 56 percent of production exported. Looking at Table 2, we can see historical levels of export subsidies for a selection of commodities. While EU consumers pay taxes to fund the support provided for their producers, U.S. consumers are able to buy the product at a lower price.

**Table 2. Total Export Subsidies by Commodity for All WTO Members, 1995-2000 (US\$mil)**

<b>Commodity category</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
Fruits and vegetables	166.4	126.4	97.7	89.8	81.5	73.3
Sugar	516.2	692.7	899.4	913.2	510.0	363.2
Milk products	2547.1	2670.7	1938.7	1992.9	2244.8	1264.5
Processed products	779.4	841.6	709.5	747.5	841.0	467.8

Source: USDA-ERS available at [www.ers.usda.gov/db/wto/](http://www.ers.usda.gov/db/wto/)

### ***Conclusion***

In this section you have learned even more about export subsidies and their effects on all players in the global marketplace. The EU has the highest rate of export subsidization of the WTO member countries. Many products from the EU compete directly with U.S. products, and so, can potentially lower the prices received by U.S. growers for their products. At the same time, the U.S. has the second highest rate of export subsidization in the world, which comes at the expense of all taxpayers, and can also serve to depress global prices of goods.

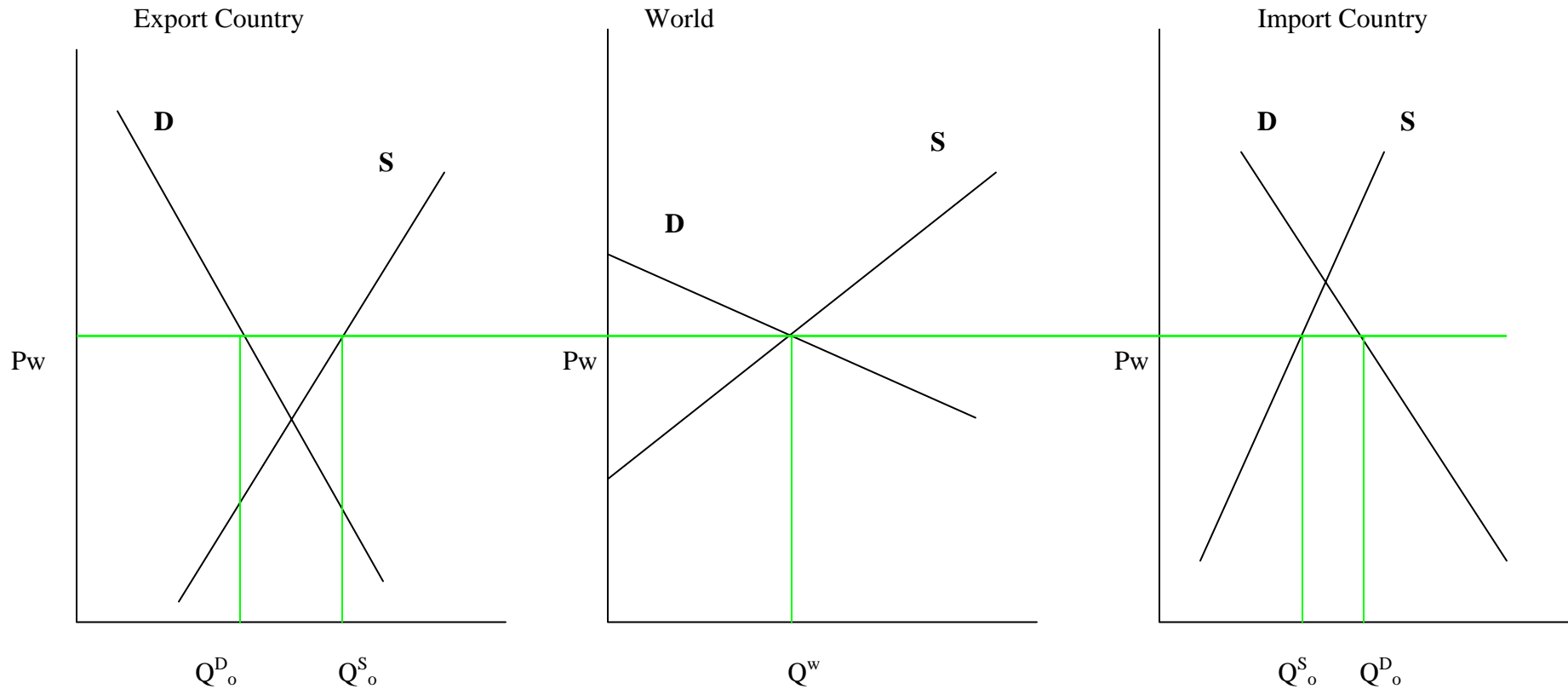
### ***Quiz***

- From Table 1, in 2000 the U.S. paid what percentage of total export subsidies paid by all WTO members for agricultural products?
  - 50%
  - 5%
  - 0.5%
  - 10%
- Subsidies reduce export earnings for other countries and cut into their global market share.  
T or F (answer T)

## **Conclusions**

In this module you have learned about export subsidies, their effects on domestic and world markets, and how the member countries of the WTO have committed to reducing both the level of subsidy and volume of product subsidized. Developed countries agreed to reducing export subsidy levels by 36 percent over the 6 year AoA implementation period. You have also learned that the EU and U.S. are the largest users of export subsidies in the world and that the sugar and dairy product industries in all WTO countries receive the highest rates of export subsidization.

**Game: Effect of Export Subsidies.**



Assume that the export country is a “large country”. The export country faces  $P_w$  prices, and in its domestic market is facing an excess supply. Notice that export country is producing  $Q^S_o$ , and its demand is  $Q^D_o$  at home.

At  $P_w$ , the import country, which is a “small country” is demanding  $Q^D_o$  and producing  $Q^S_o$ .

- a) Knowing that export country is a “large country, the government of export country decides to give an incentive to producers giving them an “export subsidy”

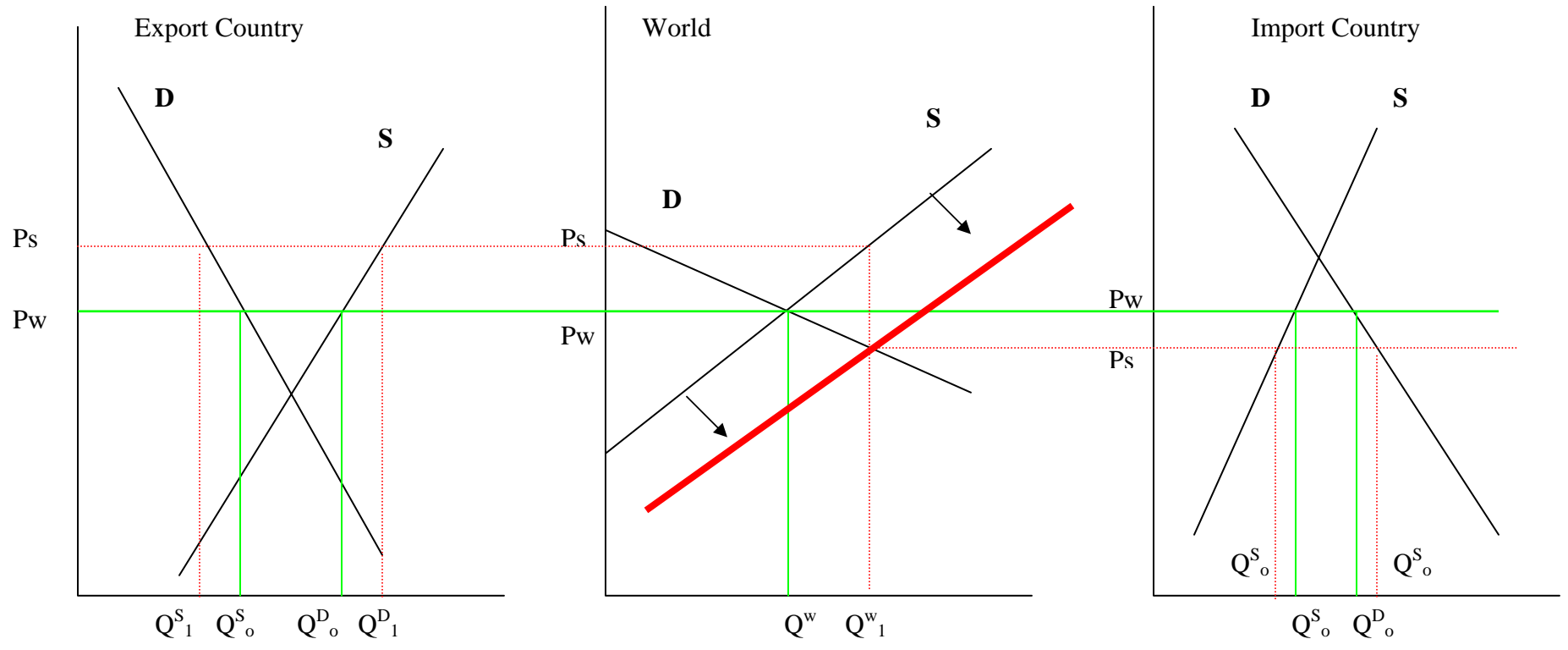
What would happen in ...?

- a) Export Country:
- a. Prices will increase in domestic market → Correct. Export subsidies create incentives to producers thru increasing local prices.
  - b. Prices will decrease in domestic market → Incorrect. Remember that Export subsidies increase local prices.
  - c. No change in prices in domestic market → Incorrect. Remember that Export subsidies incentive producers thru increasing local prices.

The new price will be  $P_s$ . Because Export country is a large country it will affect World prices. Hence, the global supply will move from  $S$  to  $S_1$ . However, prices will go down from  $P_w$  to  $P^*$ , and that will be the price that Import country will face

- b) In Import country:
- a. Prices will increase in domestic market → Incorrect.
  - b. Prices will decrease in domestic market → Correct.
  - c. No change in prices in domestic market → Incorrect.

$P^*$  is the new price that Import country will face in the global market and domestic market. Import country will decrease its domestic supply and increase its imports.



Some definitions that will appear when they click the respective word (e.g., large country)

Large country: A country that is large enough for its international transactions to affect economic variables abroad. Usually, a large country trade determines world's prices.

Small country: a country is considered “small” if what happens on the home market for a certain good has no significant influence on the world price of that specific good. A small country takes the world price as given. Notice that a country can be ‘small’ for one type of product, however, ‘large’ for another.

Export Subsidy: A payment by the government to a firm or individual that ships a good abroad.

- Policies are normally geared to meeting domestic policy objectives, such as:
  - Dispose of excess supply
  - Increase producer prices
  - Protect domestic producers
- Government gives exporter a payment on goods cleared for foreign destinations. This allows the firm to purchase the product internally at a higher price and sell it externally at a lower price.

## Questions

1. What is an export subsidy?
2. Assume you are a producer of wheat in the U.S. Why would you be opposed to increased export subsidies for wheat producers in Australia?
3. Assume you are a consumer of wheat in Iceland. What impact would export subsidies for wheat in Australia have on your budget for food?
4. Looking at Table 1 above, what percentage of world export subsidization do subsidies in the European Union account for? If the E.U. has committed to not increase export subsidies, but is planning to let six new countries into the Union in upcoming years, what are the implications for all agricultural exporters in the E.U.?

## Glossary

**Export subsidies** - are payments countries make to domestic producers that essentially lower the price of their products that are sold on the world market

## Sources of More Information

GlobalEdge - <http://ciber.msu.edu/globalEDGE/default.asp>

World Trade Organization Website – [www.wto.org](http://www.wto.org)

## References

International Agricultural Trade and Research Consortium. The Uruguay Round Agreement on Agriculture: An Evaluation. July 1994. Commissioned Paper Number 9.

Food and Agriculture Organization of the United Nations. Multilateral Trade Negotiations On Agriculture: A Resource Manual. Rome, 2000.

