



United States  
General Accounting Office  
Washington, D.C. 20548

National Security and  
International Affairs Division

B-283019

June 18, 1999

The Honorable John Kasich  
Chairman, Committee on the Budget  
House of Representatives

Subject: Commitments by the European Union and the United States to Reduce  
Agricultural Export Subsidies

Dear Mr. Chairman:

Between 1985 and 1994, the European Union (EU) spent over \$100 billion (in 1998 dollars) in agricultural export subsidies, and the United States provided over \$10 billion (in 1998 dollars) in an effort to compete against each other's prices for agricultural exports. Recognizing that such subsidies distort trade, the European Union, the United States, and other countries agreed, under the 1994 World Trade Organization's (WTO) Agreement on Agriculture ("Agreement"), to a gradual reduction in the volume and value of agricultural goods receiving export subsidies over a 6-year period ending in the year 2000.<sup>1</sup> Member nations will review progress in achieving these reductions and discuss future commitments to lower agricultural export subsidies in upcoming WTO talks on agricultural trade. These talks will begin in November 1999 in Seattle, Washington.<sup>2</sup>

As you requested, we have reviewed the EU's and the U.S.' agricultural export subsidy programs. Specifically, in this letter, we examine (1) EU and U.S. compliance with the Agreement on Agriculture commitments to reduce agricultural export subsidies and (2) EU and U.S. plans regarding the future use of agricultural export subsidies.

SUMMARY

To date, the European Union and the United States have complied with their WTO Agreement on Agriculture schedule of annual commitments to gradually reduce export subsidies for

<sup>1</sup> The Agreement also provided rules on market access and domestic support.

<sup>2</sup> The WTO was established on January 1, 1995, as a result of the Uruguay Round of the General Agreement on Tariffs and Trade, which began in 1986 and ended in 1994. The WTO facilitates the implementation, administration, and operation of multiple agreements that govern trade among its member countries.

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categories of agricultural goods.<sup>3</sup> For most agricultural categories, the European Union and the United States are below the maximum annual levels set by their schedules. For a few categories, however, the European Union and the United States exceeded their annual commitments for 1 year. According to EU and U.S. officials, in these cases, each country carried forward unused agricultural export subsidies from previous years to maintain compliance with their schedules.

The European Union and the United States differ on their future plans regarding agricultural export subsidies. The European Union recently adopted a new agricultural policy that plans further cuts in the domestic market prices of dairy products, beef, and cereals between the years 2000 and 2007, which would facilitate reductions in its agricultural export subsidies. The United States has announced that it will seek the elimination of all agricultural export subsidies in the 1999 World Trade Organization talks. These two trading partners expect the WTO negotiations to link cuts in agricultural export subsidies with changes in other trading practices. For example, the European Union plans to tie cuts in export credit guarantee programs with reductions in agricultural export subsidies, and both partners will seek more transparency (openness) in the activities of state trading enterprises as part of export subsidy reduction negotiations.

## BACKGROUND

Nations use agricultural export subsidies to help their domestic commodities become more price competitive on the world market. The EU's agricultural export subsidy system is an important element of Europe's Common Agricultural Policy (CAP). The CAP is intended to preserve farm incomes and rural economies by supporting high domestic prices for a wide variety of agricultural commodities and products. Agricultural export subsidies enable EU exporters to compete in world markets by refunding the difference between higher EU market prices and lower world market prices.<sup>4</sup> The United States currently provides agricultural export subsidies through two programs, the Export Enhancement Program (EEP) and the Dairy Export Incentive Program (DEIP), which are administered by the U.S. Department of Agriculture (USDA). These programs are intended to counter foreign competitor practices, expand markets, and facilitate sales of agricultural surpluses abroad. The U.S. agricultural export subsidies assist the export of a few bulk and semiprocessed agricultural commodities such as wheat, coarse grains, skim milk powder and cheese. Enclosure I provides more detail about the operation of the EU and U.S. agricultural export subsidy programs.

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<sup>3</sup> The schedules include a list of products and their specific levels of annual reductions by budget outlays and by volume of subsidized exports.

<sup>4</sup> The EU calls its agricultural export subsidies "restitutions" or "refunds," while the United States refers to its agricultural export subsidies as "bonuses."

Twenty-five countries made commitments in the Agreement on Agriculture to gradually reduce their agricultural export subsidies. Article 9 of the Agreement lists several types of agricultural export subsidies that are subject to reduction, including direct payments to exporters, sales of noncommercial agricultural stocks at prices lower than acquisition prices, and export payments financed through levies on producers. Export credit guarantees<sup>5</sup> and international food aid are not specifically listed as agricultural export subsidies subject to reduction commitments. However, the Agreement states that any agricultural export subsidies not specifically listed shall not be used in a manner that results in, or threatens to lead to, circumvention of the Agreement. Article 10 of the Agreement also contains specific restrictions on the use of international food aid.

Agricultural export subsidies distort prices, production, and trade flows. These subsidies lower world prices, lessening incentives in nonsubsidizing countries to produce agricultural commodities. The agricultural export subsidies also cause inefficiencies and costs in the subsidizing economy: excess product is exported and consumers pay higher prices for these goods as well as helping finance the subsidies through tax payments.

The European Union has consistently been by far the world's largest user of agricultural export subsidies and the United States has consistently ranked among the top 10 users. In 1996, the European Union reported agricultural export subsidies of \$6.3 billion to the WTO, while the United States reported \$122 million in agricultural export subsidies, which ranked fourth among subsidizing countries that year.

#### THE EUROPEAN UNION AND THE UNITED STATES ARE COMPLYING WITH THEIR COMMITMENTS TO REDUCE AGRICULTURAL EXPORT SUBSIDIES

To date, the European Union and the United States are complying with their schedules of annual commitments to reduce agricultural export subsidies over a 6-year period, according to EU and U.S. government officials. Under the 1994 Agreement, member nations committed to a schedule that, by the end of the implementation period (the year 2000), reduces their total budgetary outlays for agricultural export subsidies by at least 36 percent<sup>6</sup> and their total volume of subsidized agricultural exports by at least 21 percent. The percentage reductions are applied to a base period that averages the country's export subsidy outlays and volumes for 1986-90.<sup>7</sup> See enclosure II for a comparison of EU and U.S. total export subsidy commitments (1995-2000) and outlays to date.

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<sup>5</sup> Agricultural export credit guarantee programs offer loan guarantees to help make financing available for imports of U.S. agricultural commodities and products.

<sup>6</sup> Export subsidy commitments are set in member country currencies and are not adjusted for inflation.

<sup>7</sup> The starting point for the first year commitments could either be the amount of the base period or the average of the subsidies for 1991-92, whichever was higher.

Member nations committed to schedules that reduce the maximum value and volume of export subsidies to specified levels for different categories of agricultural exports. These reductions occur annually, beginning in 1995 and ending in the year 2000. For example, the European Union has committed to specified annual reductions to the value and volume of export subsidies for 20 agricultural categories over the implementation period, and the United States has commitments to annually reduce to specified levels the value and volume of export subsidies for 13 agricultural categories. The Agreement prohibits member nations from introducing or reintroducing agricultural export subsidies that were not subsidized during the base period. According to USDA officials, the United States currently does not use agricultural export subsidies for some commodities; however, the commodities were included in the schedule solely to retain their eligibility for agricultural export subsidies under the Agreement.

For most agricultural categories, the actual budgetary outlays and the volume of subsidized agricultural exports were below the maximum levels set each year for both the European Union and the United States. For example, in 1996, the EU's actual budgetary outlays for agricultural export subsidies were only 15 percent of the maximum level for wheat and wheat flour, the agricultural category with the largest export subsidy value. The United States used 0 percent of its annual commitment in 1996 for wheat. (See enc. III for tables that list export subsidy commitments [maximum value and volume permitted] by agricultural category as well as the actual subsidy levels for the years reported by the European Union and United States to the WTO.)

High world prices in 1995 and 1996 for some products led to actual budgetary outlays for agricultural export subsidies that were much lower than the maximum levels permitted under their schedules. These high world prices reduced the difference between the world prices and the internal prices in the United States and the European Union and subsequently reduced the amount of export subsidy needed. To a lesser extent, policy reforms in the United States in 1996 and the European Union in 1992 helped cut agricultural export subsidies by decoupling payments to producers from production levels.<sup>8</sup>

For a few agricultural categories, the European Union and the United States exceeded their annual commitments—the maximum amounts permitted under their schedule. But EU and U.S. officials say they are in compliance with their annual commitments because they “rolled over” unused agricultural export subsidies for these categories from prior years to make up the difference.<sup>9</sup> The United States and other countries initially questioned whether this practice is consistent with WTO commitments when the European Union first rolled over unused agricultural export subsidies from 1995 to meet its 1996 commitments for rice, wine, olive oil, and beef.<sup>10</sup> Despite its initial concerns, the United States rolled over unused

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<sup>8</sup> These policy reforms included the Federal Agriculture Improvement and Reform (FAIR) Act (P.L. 104-127, Apr. 4, 1996) in 1996 and the EU's changes in its Common Agricultural Policy in 1992.

<sup>9</sup> Three other countries also rolled over unused subsidies to meet their annual commitments. They were Israel, Poland, and Norway.

<sup>10</sup> The European Union rolled over unused subsidies for volume and value for rice and wine and unused subsidies for volume for olive oil and beef.

agricultural export subsidies accumulated from previous years to meet its commitment to reduce its volume of subsidized nonfat dry milk exports to a specified level in 1997.<sup>11</sup>

#### THE EUROPEAN UNION AND THE UNITED STATES DIFFER ON EXTENT OF ADDITIONAL EXPORT SUBSIDY CUTS

The European Union and the United States have different plans regarding the future use of agricultural export subsidies. The European Union has not announced a target for future agricultural export subsidy reductions, but the European Council has adopted reforms to the CAP, including lower support prices for some commodities, that would facilitate further reductions in agricultural export subsidies. The United States has stated that it will ask for elimination of all agricultural export subsidies in the 1999 WTO trade talks. The debate on agricultural export subsidy reductions in the trade talks will likely be linked with negotiations to change other trading practices, according to U.S. and European officials.

#### EU and U.S. Views on WTO Agricultural Talks in 1999

The European Union has not published its negotiating position on agricultural export subsidies for the 1999 WTO talks, but the European Council stated in March 1999 that the recently reformed CAP establishes the EU's negotiating framework for the next round of trade talks. The European Union, in March 1999, adopted a 7-year financial plan that calls for further cuts in the domestic support prices of cereals, beef, and dairy products, which affects up to 6 of the 20 agricultural categories listed in the current export subsidy reduction schedule. The gradual cuts in the domestic market prices of the agricultural products would facilitate a gradual reduction in export subsidies because the lower domestic prices will be closer to the world market prices. To preserve farm incomes lost by the lower internal market prices, the CAP continues an earlier policy of offsetting price cuts (and lost export subsidy income) with direct compensation payments to farmers, payments that are currently permitted by the Agreement.

USDA and U.S. Trade Representative (USTR) officials were disappointed at the limited extent of the reforms to the CAP. The officials believed the reductions in internal market prices, which are usually related to the level of agricultural export subsidies, were modest or not adopted. For example, the new CAP only cut cereals and beef prices by 15 percent starting in the year 2000 and delayed cuts of 15 percent in dairy product prices until 2005. In addition, there were no changes made in the prices of sugar, one of the largest export subsidy programs. The U.S. officials expected deeper cuts in the EU's internal market prices, and thus in agricultural export subsidies, in preparation for the 1999 trade talks and in

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<sup>11</sup> The United States and other countries also have expressed concerns over the EU practice of paying export subsidies for certain components of processed cheese, even though it is the processed cheese that is eventually exported. They claim that this practice allows the European Union to export a larger volume of subsidized cheese than permitted under its schedule of commitments. The European Union defends this practice by stating that it is administering its "inward processing zone" according to well recognized international principles, and therefore does not violate its schedule of commitments.

anticipation of increased budget pressures when the Czech Republic, Hungary, and Poland join the European Union. The European Council said it would monitor market developments in beef and cereals exports to determine if any other market intervention will be necessary.

The United States will call for elimination of all remaining agricultural export subsidies in the 1999 WTO talks, according to a report submitted to the WTO General Council in November 1998 and repeated in recent USDA and USTR testimony to Congress. Until the agricultural export subsidies are eliminated, the United States will also seek a more restrictive understanding of the export subsidy rules to prevent members from rolling over unused subsidy commitments. The Cairns Group, a group of 15 WTO members that supports agricultural free trade, has also called for elimination of agricultural export subsidies and additional rules on agricultural export credit guarantees to counter circumvention of subsidy reduction requirements.<sup>12</sup>

#### WTO Negotiations May Link Additional Export Subsidy Reductions With Cuts Elsewhere

WTO negotiations on export subsidy reductions will likely be tied to cuts in other agricultural trade practices, according to EU and U.S. officials. For example, the Counselor for Agriculture at the Delegation of the European Commission in Washington, D.C., said the European Union will press for changes in the U.S. export credit guarantee program in exchange for negotiations on agricultural export subsidies because those programs—export credit guarantees and agricultural export subsidies—are the most important export assistance programs from the EU's and U.S.' perspectives.

According to EU and U.S. government officials, the following trade practices will probably be tied to WTO talks on export subsidy reductions.

- Export credit guarantee programs. U.S. export credit guarantee programs help make financing available for imports of U.S. agricultural products. Such support is often important in obtaining financing in foreign markets. The programs are available for loans with terms up to 10 years, but most loans average about 2 years. In some cases, the United States, a large user of export credit guarantees, also provides export credit guarantees on exports receiving agricultural export subsidies.<sup>13</sup> In fiscal year 1998, the United States provided export credit guarantees for about \$4.3 billion in agricultural exports, about 8 percent of all U.S. agricultural exports. Some EU member countries, such as France, also operate export credit guarantee programs.<sup>14</sup> The Agreement called on members to work toward the development of internationally

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<sup>12</sup> The Cairns Group members are Argentina, Australia, Brazil, Canada, Chile, Colombia, Fiji, Indonesia, Malaysia, New Zealand, Paraguay, the Philippines, South Africa, Thailand, and Uruguay.

<sup>13</sup> See Farm Bill Export Options (GAO/GGD-96-39R, Dec. 15, 1995) and U.S. Agricultural Exports: Strong Growth Likely But U.S. Export Assistance Programs' Contribution Uncertain (GAO/NSIAD-97-260, Sept. 30, 1997) for a discussion of the U.S. export credit guarantee program.

<sup>14</sup> The actual 1998 budgetary costs associated with the U.S. credit guarantees committed in 1992 and beyond were \$259.2 million. This amount included claims on actual defaults, estimates on potential defaults, and financing costs. Similar data on the costs of competitors' export guarantee programs is not available.

agreed-upon rules on export credit guarantee programs. Negotiations on such rules were underway through the Organization for Economic Cooperation and Development,<sup>15</sup> but the negotiations stalled in March 1998 when members could not reach agreement on new rules.

- State trading enterprises (STE). Some countries, such as Australia, New Zealand, and Canada, have government organizations that are monopoly sellers of specific products, such as wheat or dairy products. These organizations set the prices on export goods on behalf of the producers. The United States and the European Union have called for more transparency (openness) in the price-setting decisions of the STEs to ensure that market-distorting prices are not being established by the organizations and that the organizations are not conduits for government export subsidies. In addition, the United States is concerned about the trading practices of STEs in countries, such as China, that are seeking admission to the WTO.<sup>16</sup>
- Food aid programs. The Agreement allowed the use of food aid programs as long as the donors ensured that the aid was not tied to commercial exports to recipients, that the aid was carried out in accordance with established international principles, and that the aid was in grant form or on terms that were not deemed highly “concessional” (low interest rates). Some WTO members have criticized the U.S. food aid programs for exceeding the terms of the Agreement and serving as subsidy-like support for U.S. farmers to assist them in selling surplus commodities.<sup>17</sup>

Several bilateral agricultural trade issues have increased the tension in the U.S.-EU trade relationship, such as market access for agricultural products containing genetically modified organisms<sup>18</sup> and EU compliance with WTO dispute settlement decisions on imported bananas and the use of beef hormones. The EU Agriculture Counselor in Washington, D.C., said the European Union and the United States are trying to ease the tensions through bilateral discussions, but he would not rule out the possibility that the issues would be raised in the 1999 WTO trade talks.

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<sup>15</sup> The Organization for Economic Cooperation and Development is an international forum for monitoring economic trends and coordinating economic policy among 29 developed countries, including the EU countries and the United States.

<sup>16</sup> See U.S. Agricultural Trade: Canadian Wheat Issues (GAO/NSIAD-99-21, Oct. 16, 1998); Canada, Australia, and New Zealand: Potential Ability of Agricultural State Trading Enterprises to Distort Trade (GAO/NSIAD-96-94, June 24, 1996); and State Trading Enterprises: Compliance with the General Agreement on Tariffs and Trade (GAO/GGD-95-208, Aug. 30, 1995) for a discussion of STEs.

<sup>17</sup> See Food Aid: Competing Goals and Requirements Hinder Title I Program Results (GAO/GGD-95-68, June 26, 1995) for a discussion of food assistance issues.

<sup>18</sup> See Agricultural Exports: U.S. Needs a More Integrated Approach to Address Sanitary/Phytosanitary Issues (GAO/NSIAD-98-32, Dec. 11, 1997) for more details.

AGENCY COMMENTS

We discussed a draft of this letter with USDA and USTR officials. The officials agreed with our overall observations and analysis. They also provided technical changes, which we incorporated where appropriate.

SCOPE AND METHODOLOGY

To examine EU and U.S. compliance with the agricultural export subsidy reduction commitments of the 1994 WTO Agreement on Agriculture, we reviewed data on the Agreement's subsidy reduction commitments from the WTO annual notifications of the European Union and United States and from USDA materials. We also interviewed and collected documents from USDA officials in Washington, D.C.; and Geneva, Switzerland; and USTR officials in Washington, D.C., on the extent of the EU's and U.S.' compliance with the Agreement's export subsidy reduction commitments. In addition, we interviewed an official and collected documents on the EU export subsidy program from the EU Delegation in Washington, D.C. We interviewed USDA and EU officials and collected documents to identify how the United States and the European Union operate their agricultural export subsidy programs. Finally, we talked with representatives of individual commodity groups to discuss their concerns about the Agreement's export subsidy reduction commitments and the impact on their commodities.

To examine the EU's and U.S.' plans for future use of agricultural export subsidies, we interviewed USDA, USTR, and EU officials in Washington, D.C., and Geneva, Switzerland. We reviewed USDA and USTR congressional testimony and documents on U.S. objectives regarding agricultural export subsidies. We also reviewed EU documents on the CAP and the March 1999 CAP reform to identify the EU's plans for future agricultural export subsidies. Finally, we reviewed USDA, USTR, EU, Cairns Group, and WTO documents on preparations for the November 1999 WTO talks.

We conducted our review from January to June 1999 in accordance with generally accepted government auditing standards.

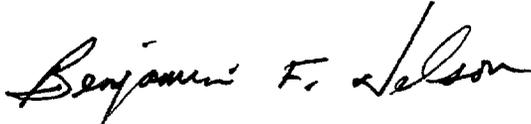
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As agreed with your office, unless you publicly announce the contents earlier, we plan no further distribution of this letter until 30 days after its issue date. At that time, we will provide copies to interested congressional Committees; the Honorable Dan Glickman, the Secretary of Agriculture; and the Honorable Charlene Barshefsky, the U.S. Trade Representative. We will also make copies available to other interested parties on request.

B-283019

Please contact me or Phil Thomas at (202) 512-4128 if you or your staff have any questions regarding this letter. The major contributors to this letter were Christine Broderick, Dennis Richards, and Samantha Roberts.

Sincerely yours,

A handwritten signature in black ink that reads "Benjamin F. Nelson". The signature is written in a cursive style with a large initial 'B' and a long, sweeping underline.

Benjamin F. Nelson  
Director, International Relations and Trade Issues

Enclosures (3)

## HOW THE EUROPEAN UNION (EU) AND THE UNITED STATES OPERATE THEIR EXPORT SUBSIDY PROGRAMS

In both the United States and the European Union, the agricultural export subsidies subject to reductions in the World Trade Organization's (WTO) Agreement on Agriculture ("Agreement") are payments that compensate exporters for the difference between lower world prices and higher domestic prices. The EU agricultural export subsidy system is an important component of the Common Agricultural Policy (CAP) that aims to protect and stabilize the incomes of EU farmers through price support mechanisms. The European Union generally sets the prices of agricultural products within the European Union at levels that are higher than the world prices for the products. In contrast, U.S. export subsidy programs are a less significant part of U.S. farm policy. According to officials from the U.S. Department of Agriculture (USDA), U.S. agricultural export subsidy programs are intended to expand markets and counter competition from subsidizing countries, especially the European Union. Both EU and U.S. subsidy programs facilitate the sale of agricultural surpluses.

The EU agricultural export subsidy system is much larger than the U.S. agricultural export subsidy programs. The European Union reported to the WTO \$6.3 billion in export subsidies in 1996 that supported a wide range of agricultural exports. In comparison, the United States reported to the WTO \$122 million in 1996 agricultural export subsidies that supported a few products.

### THE EU'S AGRICULTURAL EXPORT SUBSIDY SYSTEM

Agricultural export subsidies are an important component of the CAP. When designed in the 1960s, the CAP was intended to stimulate increased agricultural production and productivity in the European Union in part by setting a target price for agricultural products that EU officials regard as the optimum price a farmer should receive. These prices were generally higher than world prices, providing an incentive for higher EU production and a need to deter imports. While production has risen, demand has leveled off, resulting in surplus products on the EU market, costly programs to store the surpluses, and agricultural export subsidies to sell the surpluses on world markets.

To stabilize domestic agricultural markets, the CAP uses three mechanisms to maintain EU market prices of agricultural products around a target price. One mechanism is the intervention price—the minimum allowable price before the government intervenes in the market. Producers who are unable to find buyers for their products can sell their surpluses to the government at the intervention price. Another mechanism is import levies—tariffs on imported agricultural products set at levels to ensure that the imports are not undercutting EU target prices. A third market mechanism is agricultural export subsidies—payments to exporters that are equal to the difference between the EU internal market price and market

prices outside the European Union.<sup>1</sup> Agricultural export subsidies enable the EU exporters to compete in world markets.

All commodities that are regulated under the CAP have this basic structure, but there is some variation in the procedures for determining target prices, intervention prices, and subsidy levels. For example, the market mechanisms for dairy products and cereals are slightly different. Target prices for all dairy products are based on the target prices of just two products, butter and dried skim milk.<sup>2</sup> By controlling the target price and availability of these two products, the CAP also affects the prices of other dairy products, such as cheese. CAP authorities fix the amount of the agricultural export subsidies for dairy products according to prevailing market prices outside the European Union and the destination. In contrast, the CAP authorities currently set only one target price for a single standard quality of cereal grain. This price applies to all the main grains—wheat, barley, rye, maize, and sorghum. The intervention price has been maintained at broadly ten percent below the target price, and both the intervention and target price increase by fixed increments during the season. Unlike dairy products, agricultural export subsidies for cereals are determined more frequently by a competitive bidding process (tenders), in which subsidies for agricultural exports are awarded to bidders who make the lowest subsidy request. Under certain circumstances, fixed agricultural export subsidies without tenders on cereals may be available for grain shipments to specific destinations.

Because agricultural export subsidies are one of the three mechanisms used to support EU agricultural prices and farm incomes, any reductions in agricultural export subsidy levels have been, and continue to be, dependent upon changes in the CAP. Agricultural export subsidies for dairy, cereals, and other product categories are dependent upon the levels of support prices—the target price and the intervention price. In 1992, the European Union undertook reforms in the CAP market support system to reduce intervention prices and surpluses and, thereby, lower agricultural export subsidies and help the European Union achieve its commitment in the Agreement on Agriculture. Measures were implemented to limit supplies through quota systems, controls on use of land, and direct income payments to farmers. In the latest CAP reform, Agenda 2000, the European Commission approved a reduction in the intervention price for cereals, beef, and dairy products, accompanied by increases in direct payments to farmers to offset the price decrease. The reform of the CAP within the framework of Agenda 2000 is viewed by the European Council as essential for defining the Commission's negotiating mandate for the upcoming 1999 WTO talks on agricultural trade.

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<sup>1</sup> In the rare event that market prices outside the European Union exceed internal EU market prices, a levy is imposed on exports out of the European Union to prevent exports from undercutting world prices and to discourage the movement of grain out of the European Union. During 1995/96, due to high world cereal prices, export levies were applied to wheat, barley and durum wheat.

<sup>2</sup> Dairy export subsidies change according to market conditions. Export subsidies rise when there is an increase in intervention stocks of milk and butter and fall when these stocks decrease.

THE U.S. EXPORT SUBSIDY PROGRAMS: EXPORT ENHANCEMENT PROGRAM (EEP)  
AND DAIRY EXPORT INCENTIVE PROGRAM (DEIP)

Currently, the United States provides export subsidies for agricultural products through two programs: EEP and DEIP.<sup>3</sup> These programs were instituted in 1985 after several years of declining U.S. agricultural exports, growing surplus grain stocks, and increasing competition in traditional markets from countries using agricultural export subsidies, especially the European Union. These programs are intended to counter the adverse affects of foreign subsidies, expand U.S. agricultural exports, and facilitate the sale of agricultural surpluses overseas by compensating exporters for the difference between lower world prices and higher domestic prices for targeted products and destinations.<sup>4</sup>

Under the U.S. export subsidy programs, USDA pays cash to exporters as "bonuses," allowing them to sell U.S. agricultural products in targeted countries at prices lower than the exporter's costs of acquiring them. Before 1992, EEP subsidies were not cash; rather, EEP subsidies were in the form of certificates for government-owned commodities. The same is true for DEIP, except that initially, subsidies were payments-in-kind from CCC-owned dairy stocks; later, they were in the form of generic commodity certificates from government-owned inventories.

Until fiscal year 1996, EEP was by far the larger of the two programs in terms of budgetary outlays. More than 77 percent of the \$1.1 billion in EEP subsidies in fiscal year 1994 were for wheat exports. In fiscal year 1995, the last year EEP subsidies were used for wheat, the United States awarded \$339.5 million in EEP subsidies. The total value of EEP subsidies dropped significantly in fiscal year 1996, to \$5.2 million, and supported only the export of frozen poultry. No EEP subsidies were used in fiscal year 1997. In fiscal year 1998, the United States awarded \$2.1 million in EEP subsidies to support the export of frozen poultry and coarse grains. Other commodities eligible for EEP assistance but not exported in fiscal years 1996-1998 were wheat, wheat flour, rice, barley, barley malt, table eggs, and vegetable oil.<sup>5</sup>

In fiscal year 1994, DEIP was about one-tenth the size of EEP, awarding \$118 million in subsidies to support the export of U.S. dairy products. By fiscal year 1996, the total value of

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<sup>3</sup> In 1988, two other export subsidy programs were established, the Cottonseed Oil Assistance Program (COAP) and the Sunflowerseed Oil Assistance Program (SOAP); however, these programs were not reauthorized under the 1996 Federal Agriculture Improvement and Reform Act (P.L. 104-127, Apr. 4, 1996). Although not currently used, subsidies for the export of U.S. agricultural commodities are also available through the direct sales of surplus stocks owned by the Commodity Credit Corporation (CCC), a government-owned and -operated corporation responsible for financing major USDA programs including price supports, domestic and foreign food assistance, and export sales programs. In the past, the CCC has sold commodities in its inventories overseas at prices lower than the domestic purchase price, but has not done so since fiscal year 1995.

<sup>4</sup> See *U.S. Agricultural Exports: Strong Growth Likely But U.S. Export Assistance Programs' Contribution Uncertain* (GAO/NSIAD-97-260, September 30, 1997) for a discussion of the U.S. export subsidy programs' contribution to agricultural trade.

<sup>5</sup> In its annual WTO notifications, the United States reports its EEP and DEIP subsidy values for the fiscal year beginning in the WTO notification year. For example, the 1995 WTO notification year used data from the 1996 fiscal year, which began in October 1995 and ended in September 1996.

DEIP subsidies dropped significantly to \$20 million and then in fiscal year 1997 rose to \$122 million. In fiscal year 1998, the United States awarded \$110 million in DEIP subsidies, an amount 50 times larger than total EEP subsidies. Products exported under DEIP in fiscal years 1996-1998 were butterfat, milk powder (nonfat dry and whole), and cheeses. The United States also subsidized the direct sales of government-owned dairy products in fiscal years 1994 and 1995 by selling the commodities overseas for prices lower than the domestic purchase price. The total value of the direct sales subsidies in fiscal year 1994 was \$10.3 million and \$6.6 million in fiscal year 1995. According to USDA officials, fiscal year 1995 was the last year that the United States used direct sales subsidies to assist the export of U.S. dairy products. Although the legislative authority still exists, USDA has decided not to use direct sales subsidies because of a decrease in government-owned stocks, a preference within the dairy industry to use DEIP.

EEP and DEIP operate under a bid-bonus system in which an exporter submits bids to USDA in order to sell eligible agricultural commodities in specific markets overseas. To begin the process, USDA determines which commodities and countries USDA should target under the programs by submitting various proposals to the Trade Policy Review Group<sup>6</sup> for approval. An approved proposal is then published in bid announcements as initiatives, detailing the targeted country, the commodity, and the quantity approved for sale.<sup>7</sup> Once USDA offers an invitation for bids, it is up to agricultural exporters to contact prospective buyers in eligible countries and negotiate a sales contract covering price, quantity, quality, delivery, and other terms. Each prospective exporter submits a bid to USDA requesting a subsidy—or bonus—that would allow the sale to take place at the agreed price. USDA reviews all bids for the competitiveness of the bonus value requested and then compares the bids with offers from other U.S. exporters and sales of competitor countries. USDA has the right to reject any or all bids. All sales under EEP and DEIP are made by the private sector, not the U.S. government.

Farm legislation passed in 1985, and later in 1990, also brought about market-oriented reforms in domestic agricultural policy that were designed, among other things, to reduce agricultural export subsidies. These reforms helped reduce the market-distorting impact of government-established price supports and diminished holding of surplus stocks. The Federal Agriculture Improvement and Reform Act of 1996 expanded on market-oriented provisions of previous legislation and for many commodities ended the tying of direct farm income support to production decisions.

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<sup>6</sup> The Trade Policy Review Group is an interagency body that reviews, among other things, USDA's export EEP and DEIP proposals to ensure compliance with U.S. national trade policy objectives. As part of its duties, the Trade Policy Review Group reviews decisions regarding USDA export subsidy commodity allocation.

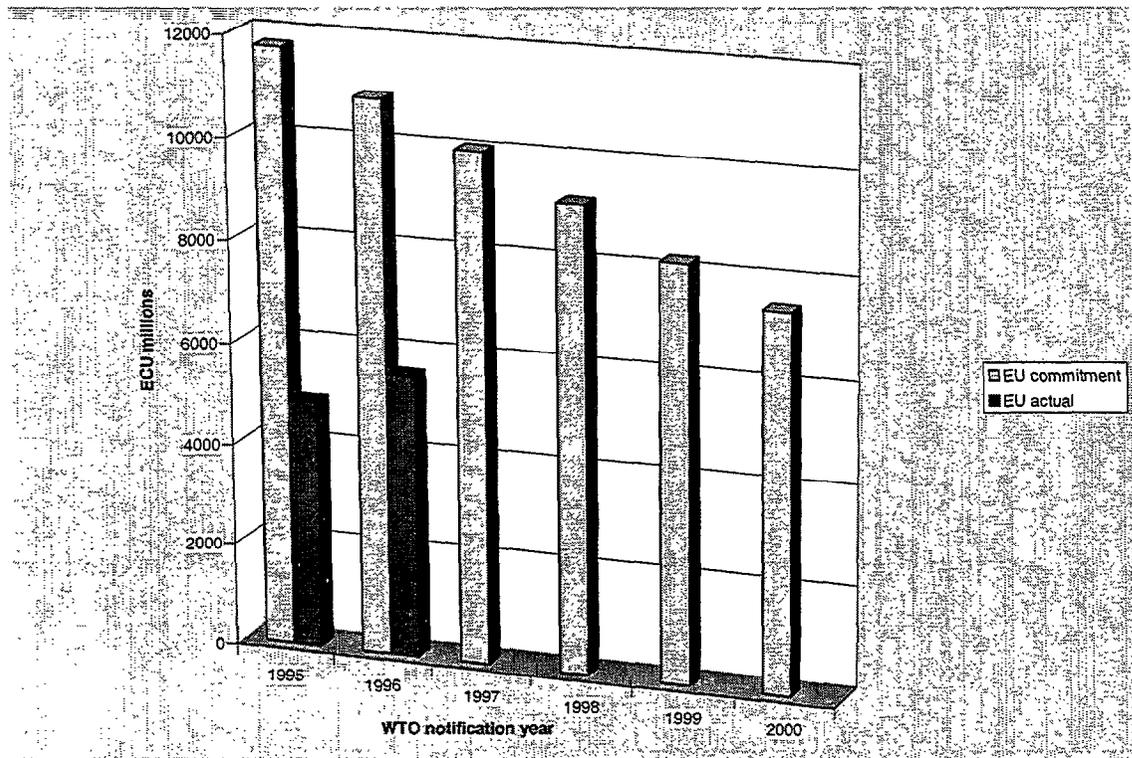
<sup>7</sup> USDA considers four criteria to select the commodities and countries that best meet the EEP's trade policy objectives: (1) a trade policy effect: further U.S. ability to combat unfair trade practices in targeted markets; (2) an export effect: develop, expand, or maintain markets for U.S. agricultural commodities that would be competitive if other suppliers did not use export subsidies; (3) effects on nonsubsidizers: approve only those EEP initiatives that will not have more than minimal effect on nonsubsidizing exporters in the market; and (4) subsidy requirements: maintain the overall program level at minimum levels necessary to achieve the expected benefits of the program.

EU AND U.S. TOTAL EXPORT SUBSIDY COMMITMENTS  
AND OUTLAYS TO DATE, 1995-2000

The WTO monitors the annual export subsidy outlays and volume of subsidized exports for each agricultural category to measure compliance with the schedules of annual commitments. However, from a budget perspective, a comparison of the total value of agricultural export subsidies allowed by the commitment schedule with the total actual outlays shows the potential and actual impact of the schedules on the domestic budgets. Figures II.1 and II.2 illustrate this concept for the European Union and the United States.

Figure II.1: EU Agricultural Export Subsidies: Total Value of Subsidy Commitments and Actual Outlays, 1995-2000

(ECU in millions)



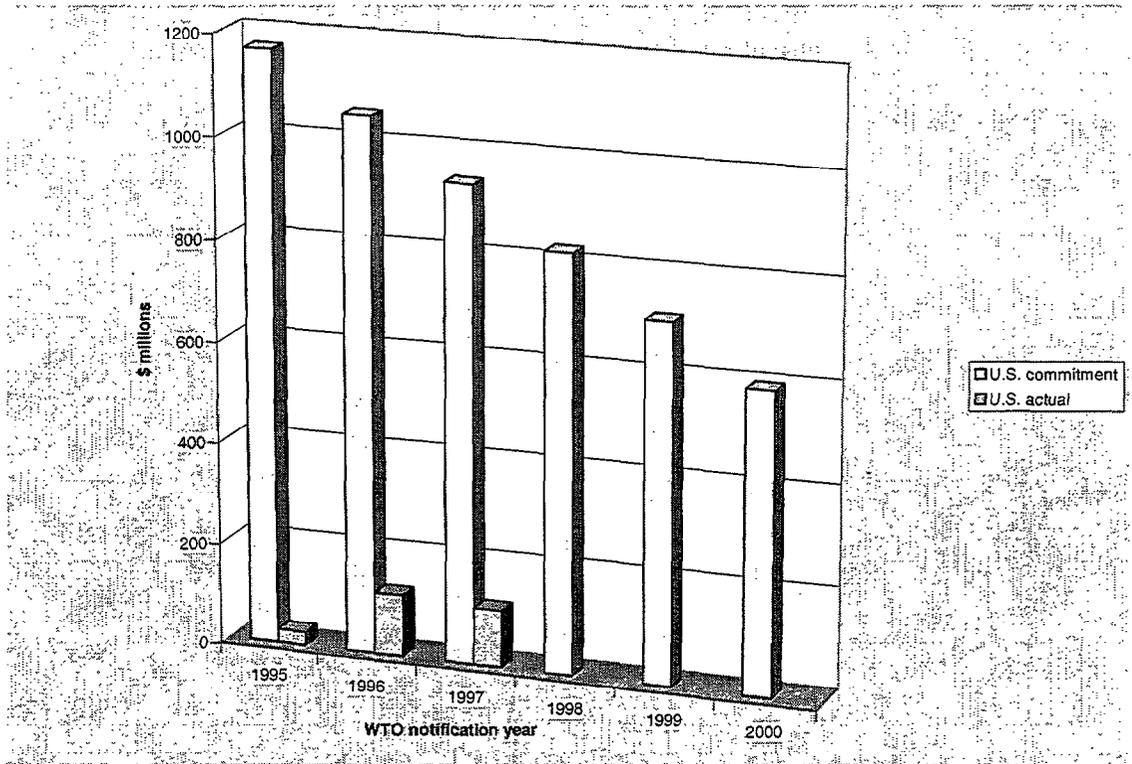
Note 1: While the report on actual agricultural export subsidies for 1997 was due in March 1999, so far the European Union has submitted reports for 1995 and 1996 only.

Note 2: The "ECU" represents the European Currency Unit. In 1999, the ECU converted to the "euro," with a 1:1 relationship. The exchange rate with the U.S. dollar has varied since 1995. On April 21, 1995, \$1 equaled 1.32 ECUs, while on April 21, 1999, \$1 equaled 1.06 euros.

Source: GAO analysis of WTO notifications.

Figure II.2: U.S. Agricultural Export Subsidies: Total Value of Subsidy Commitments and Actual Outlays, 1995-2000

(U.S. dollars in millions)



Source: GAO analysis of WTO notifications.

EU AND U.S. AGRICULTURAL EXPORT SUBSIDY DATA

Under the 1994 WTO Agreement on Agriculture, WTO members agreed to report their actual agricultural export subsidies by agricultural categories to the WTO Committee on Agriculture each year, starting in 1995. The format for the annual notification to the WTO includes presenting the maximum level of agricultural export subsidies allowed in the schedule of annual commitments and the actual agricultural export subsidies, in value and volume for each commodity category. As of June 3, 1999, the European Union has reported its use of export subsidies to the WTO for 1995 and 1996 and has yet to report its export subsidies for 1997, due March 1999. The United States has reported its use of export subsidies for 1995, 1996, and 1997.<sup>1</sup>

The following tables present annual export subsidy commitments by agricultural categories (the maximum levels listed in the schedule) and actual agricultural export subsidies for the European Union and the United States.

- Tables III.1 and III.2 show the agricultural export subsidy reduction commitments and actual subsidy data, by value and volume, for the European Union for 1995 and 1996. The actual budgetary outlays for agricultural export subsidies were generally a lower percentage of the maximum levels set that year than the actual volume of subsidized exports. For example, the actual export subsidy outlay for pigmeat in 1996 was 26.4 percent of the maximum level allowed, while the actual volume of subsidized pigmeat was 54.8 percent. The tables also show that the European Union exceeded the maximum level allowed on its outlays for rice and wine (table III.1) and on volume for rice, olive oil, beef, and wine (table III.2) in 1996. The European Union said that it still complied with its schedule of annual commitments because it relied on unused agricultural export subsidies from 1995 to make up the difference.
- Tables III.3 and III.4 show the agricultural export subsidy commitments and actual subsidy data, by value and volume, for the United States for 1995, 1996, and 1997. Unlike the EU data, the value and volume of U.S. agricultural export subsidies cannot be compared because the reporting periods for outlays and volumes are different. The United States exceeded the export subsidy ceiling for skim milk powder in volume in 1997 but said that it still complied with the schedule of annual commitments because it drew on unused agricultural export subsidies from prior years.

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<sup>1</sup> The European Union and the United States use different reporting periods in their annual WTO notifications. The European Union refers to its 1995/1996 marketing year as the reporting period of subsidies by outlay and quantity for the 1995 WTO notification. The 1995/1996 marketing year varies by product category. For example, the 1995/1996 marketing year for wheat and wheat flour began July 1, 1995, while the 1995/1996 marketing year for olive oil began November 1, 1995. For its WTO notifications, the United States uses marketing years for reporting quantity commitments, which begins on July 1 of the notification year, and fiscal years for reporting on subsidy outlays, which begins on October 1 of the notification year. For example, the 1995 WTO notification for all U.S. product categories reported quantity commitments for the marketing year beginning July 1, 1995, and subsidy outlays for the fiscal year beginning October 1, 1995. In this letter, the term "WTO notification year" refers to the subsidies reported by the European Union for its marketing year and those subsidies reported by the United States for its marketing year (for quantity) and fiscal year (for outlay).

Table III.1: EU Agricultural Export Subsidy Commitments: Maximum Levels and Actual Subsidies, by Value, 1995, 1996, and Year 2000 WTO Notification Years

(ECUs in millions)

	1995			1996			2000
	Maximum level	Actual subsidies	% used	Maximum level	Actual subsidies	% used	Final maximum level
Alcohol	141.2	51.2	36.3%	132.2	118.5	89.6%	96.1
Beef meat	1,922.6	1,506.5	78.4%	1,788.7	1,526.7	85.4%	1,253.6
Butter and butteroil	1,392.1	256.2	18.4%	1,303.3	551.8	42.3%	947.8
Cheese	594.1	437.6	73.7%	543.6	271.3	49.9%	341.7
Coarse grains	1,605.7	303.4	18.9%	1,493.9	389.0	26.0%	1,046.9
Eggs	60.7	12.9	21.3%	57.3	6.9	12.0%	43.7
Fruits and vegetables, fresh	77.6	70.4	90.7%	72.6	61.8	85.1%	52.8
Fruits and vegetables, processed	12.2	11.3	92.6%	11.4	10.2	89.5%	8.3
Incorporated products <sup>a</sup>	717.4	491.1	68.5%	656.8	565.9	86.2%	415.0
Olive oil	79.8	62.1	77.8%	74.7	39.0	52.2%	54.3
Other milk products	1,024.7	727.6	71.0%	959.3	732.0	76.3%	697.7
Pigmeat	288.8	100.5	34.8%	269.3	71.1	26.4%	191.3
Poultry meat	136.3	115.9	85.0%	127.2	73.0	57.4%	90.7
Rapeseed	40.7	0	0%	38.1	0	0%	27.7
Raw tobacco	96.6	18.2	18.8%	85.3	3.4	4.0%	40.2
Rice	54.6	30.3	55.5%	51.1	72.2	141.3%	36.8
Skim milk powder	406.2	140.9	34.7%	380.1	170.1	44.8%	275.8
Sugar	733.1	379.0	51.7%	686.3	525.0	76.5%	499.1
Wheat and wheat flour	2,309.0	118.7	5.1%	2,105.0	317.5	15.1%	1,289.7
Wine	57.5	51.1	88.9%	53.9	59.6	110.6%	39.2
Total	11,750.9	4,884.9	41.6%	10,890.1	5,565.0	51.1%	7,448.4

Note: "ECU" represents European Currency Unit. In 1999, the ECU converted to the "euro," with a 1:1 relationship. The exchange rate with the U.S. dollar has varied since 1995. On April 21, 1995, \$1 equaled 1.32 ECUs, while on April 21, 1999, \$1 equaled 1.06 euros.

<sup>a</sup>Incorporated products include basic or processed items incorporated into products not found in the other categories.

Source: WTO Committee on Agriculture.

Table III.2: EU Agricultural Export Subsidy Commitments: Maximum Levels and Actual Subsidies, by Volume, 1995, 1996, and Year 2000 WTO Notification Years

(In thousands of metric tons, except for wine and alcohol)

	1995			1996			2000
	Maximum level	Actual subsidies	% used	Maximum level	Actual subsidies	% used	Final maximum level
Alcohol (1,000 hectoliters)	1,401.6	450.0	32.1%	1,350.7	1,070.4	79.2%	1,147.4
Beef meat	1,137.0	1,019.1	89.6%	1,073.9	1,177.4	109.6%	821.7
Butter and butteroil	487.8	146.4	30.0%	470.1	276.0	58.7%	399.3
Cheese	426.5	422.3	99.0%	405.4	401.9	99.1%	321.3
Coarse grains	13,690.2	6,596.4	48.2%	13,120.6	11,844.5	90.3%	10,843.2
Eggs	126.1	95.1	75.4%	120.6	67.9	56.3%	98.8
Fruits and vegetables, fresh	920.3	909.5	98.8%	886.9	874.2	98.6%	753.4
Fruits and vegetables, processed	175.1	93.6	53.5%	168.7	136.1	80.7%	143.3
Incorporated products <sup>a</sup>	no limit			no limit			no limit
Olive oil	140.5	135.5	96.4%	135.4	140.4	103.7%	115.0
Other milk products	1,185.4	1,156.7	97.6%	1,140.0	1,140.0	100.0%	958.1
Pigmeat	541.8	378.2	69.8%	522.1	285.9	54.8%	443.5
Poultry meat	434.5	418.1	96.2%	404.7	401.4	99.2%	286.0
Rapeseed	126.8	0	0%	122.2	0	0%	103.8
Raw tobacco	190.0	11.2	5.9%	174.1	2.0	1.1%	110.8
Rice	163.0	88.6	54.4%	157.1	226.5	144.2%	133.4
Skim milk powder	335.0	241.2	72.0%	322.5	269.5	83.6%	272.5
Sugar	1,555.6	856.3	55.0%	1,499.2	1,200.3	80.1%	1,273.5
Wheat and wheat flour	20,408.1	2,768.8	13.6%	19,212.7	14,410.0	75.0%	14,438.0
Wine (1,000 hectoliters)	2,851.4	2,161.0	75.8%	2,742.1	3,034.9	110.7%	2,304.7

<sup>a</sup>Incorporated products include basic or processed items incorporated into products not found in the other categories.

Source: WTO Committee on Agriculture.

Table III.3: U.S. Agricultural Export Subsidy Commitments: Maximum Levels and Actual Subsidies, by Value, 1995-1997, and Year 2000 WTO Notification Years

(U.S. dollars in millions)

	1995			1996			1997			2000
	Maximum level	Actual subsidies	% used	Maximum level	Actual subsidies	% used	Maximum level	Actual subsidies	% used	Final maximum level
Bovine meat	\$33.5	\$0	0%	\$31.4	\$0	0%	\$29.2	\$0	0%	\$22.8
Butter and butteroil	44.8	0	0%	41.9	20.1	48%	39.1	8.9	23%	30.5
Cheese	5.3	2.1	39.6%	5.0	2.5	50%	4.7	3.9	83.0%	3.6
Coarse grains	67.7	0	0%	63.4	0	0%	59.1	1.2	2%	46.1
Eggs	7.6	0	0%	6.4	0	0%	5.2	0	0%	1.6
Live dairy cattle	17.5	0	0%	16.3	0	0%	15.2	0	0%	11.9
Other milk products	14.4	1.6	11.1%	11.5	5.1	44.3%	8.6	8.6	100.0%	0
Pigmeat	0.7	0	0%	0.7	0	0%	0.6	0	0%	0.5
Poultry meat	21.4	5.2	24.3%	20.0	0	0%	18.6	0.9	4.8%	14.6
Rice	15.7	0	0%	13.0	0	0%	10.4	0	0%	2.4
Skim milk powder	121.1	16.8	13.9%	113.4	93.8	83%	105.7	88.8	84%	82.5
Vegetable oils	53.0	0	0%	45.2	0	0%	37.4	0	0%	14.1
Wheat	765.5	0	0%	685.2	0	0%	604.8	0	0%	363.8
Total	\$1,168.2	\$25.7	2.2%	\$1,053.4	\$121.5	11.5%	\$938.6	\$112.3	12.0%	\$594.4

Note: Due to rounding the amount of other milk products in the year 2000, this amount does not reflect the actual U.S. final commitment of \$20,974 in export subsidies.

Source: WTO Committee on Agriculture.

Table III.4: U.S. Agricultural Export Subsidy Commitments: Maximum Levels and Actual Subsidies, by Volume, 1995-1997 and Year 2000 WTO Notification Years

(In thousands of metric tons, except for live dairy cattle and eggs)

	1995			1996			1997			2000
	Maximum level	Actual subsidies	% used	Maximum level	Actual subsidies	% used	Maximum level	Actual subsidies	% used	Final maximum level
Bovine meat	21.5	0	0%	20.7	0	0%	19.9	0	0%	17.6
Butter and butteroil	43.0	0	0%	38.6	9.3	24.1%	34.2	15.6	45.6%	21.1
Cheese	3.8	3.3	86.8%	3.7	3.0	81.1%	3.5	3.5	100.0%	3.0
Coarse grains	1,906.3	0.3	0%	1,837.2	0	0%	1,768.0	25.0	1.4%	1,560.6
Eggs (1,000 dozen)	30,261.8	7,565.5	25.0%	25,593.4	0	0%	20,924.9	0	0%	6,919.6
Live dairy cattle (head)	13,467	0	0%	12,978	0	0%	12,490	0	0%	11,024
Other milk products	12.5	4.5	36.0%	10.0	2.2	22.0%	7.5	7.5	100.0%	0
Pigmeat	0.5	0	0%	0.5	0	0%	0.4	0	0%	0.4
Poultry meat	34.2	22.3	65.2%	33.0	0	0%	31.7	0	0%	28.0
Rice	271.7	9.9	3.6%	225.0	0	0%	178.4	0	0%	38.6
Skim milk powder	108.2	63.7	58.9%	100.2	69.9	69.8%	92.2	96.3	104.4%	68.2
Vegetable oils	587.5	0	0%	498.3	0	0%	409.0	0	0%	141.3
Wheat	20,238.3	559.8	2.8%	19,095.1	0	0%	17,951.8	0	0%	14,522.0

Note: Due to rounding the amount of other milk products in the year 2000, this amount does not reflect the actual U.S. final commitment of 34 metric tons in subsidized exports.

Source: WTO Committee on Agriculture.

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