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Chapter 10

Common Agricultural Policy Rebalancing

The Basis For Possible Agreement

James Gleckler*
Luther Tweeten**

Introduction

The European Community (EC) is the world leader in oilseed consumption. The 1962 Dillon Round of GATT provides foreign oilseeds free access to Community consumers at world prices. Oilseeds as a feed component became very important as the Community livestock sector expanded. High support prices for livestock products and grain have shifted demand toward oilseeds and shifted domestic production away from oilseeds. These distortions are of primary concern to European Community policymakers who want to "rebalance" market protection and support away from grains and toward oilseeds. The rebalancing issue is central to the negotiations on agricultural support reduction in the GATT. If there is a rebalancing formula to which the United States might agree, it would have to leave U.S. producers no worse off. We

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used a world trade simulation model to estimate the welfare effects of several rebalancing schemes. Results show that rebalancing with European price supports reduced 20-25 percent leave U.S. producers no worse off in the short term.

The 1962 Dillon Round Concession committing the EC to duty-free bindings (no restrictions) on oilseed imports was given by the EC in exchange for allowing trade barriers in the newly formed Common Agricultural Policy (CAP) to protect high domestic price supports on grains from foreign imports. CAP border measures isolated the high supports from world markets.

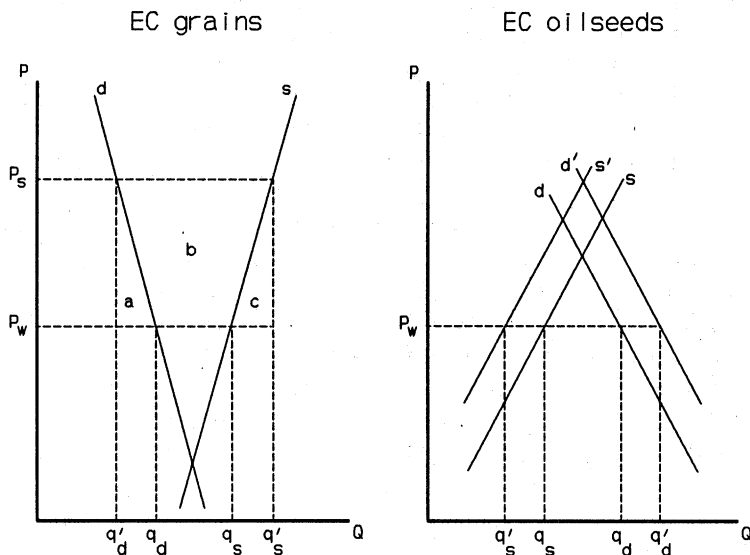
The EC was a net importer of major farm commodities in 1962. Grain exporting countries did not foresee that the high grain price supports and increased productivity would eventually give the EC a major grain surplus which would, in the absence of production controls, receive massive export subsidies. Duty-free access of oilseeds and corn-gluten feeds reduced opportunities to feed excess EC grains to livestock. With the chance in the 1990's to renegotiate the Dillon Round, the EC would probably not agree to exclude oilseeds from its CAP nor would the United States agree to no limits on export subsidies to dispose of EC grain surpluses.

Rapid expansion of the EC livestock sector has made oilseed components of feeds very important. The EC is the world leader in oilseed consumption and oilseed imports. The Community would like to extract the internal farm income and price stability benefits of variable levies and reduce internal competition from cheap protein feeds in this huge market, but has been unsuccessful thus far.

Farm income benefits, stability, and levy receipts are not the only reasons for desiring change. The left panel in figure 1 illustrates the high supports and isolation achieved by EC border measures in most commodities, including grains. High domestic market price support (P_d) in excess of world market price P_w has decreased consumption (q_d to q_d') and increased production (q_s to q_s'). EC agricultural officials perceive that extensive market support in grains and other crops has caused inconsistent distortions in the grain sector and in the unprotected oilseed sector. Increased production in grains has shifted production away from substitutes such as oilseeds, reducing supply s to s' (right panel of figure 1). High prices for grain components of feed mixes have also shifted demand toward nongrain ingredients such as oilseeds, raising oilseed

Figure 1

Oilseed distortions from EC market price support to grains



demand d to d' . These distortions have increased oilseed imports from $q_d - q_s$ to $q'_d - q'_s$. High levels of livestock production support have increased demand for both grains and oilseeds.

In addition, export subsidies on grains, area $a+b+c$ in the left panel, have become very demanding on the CAP budget. Prohibition of oilseed import restrictions precludes tariff receipts to help balance the CAP budget.

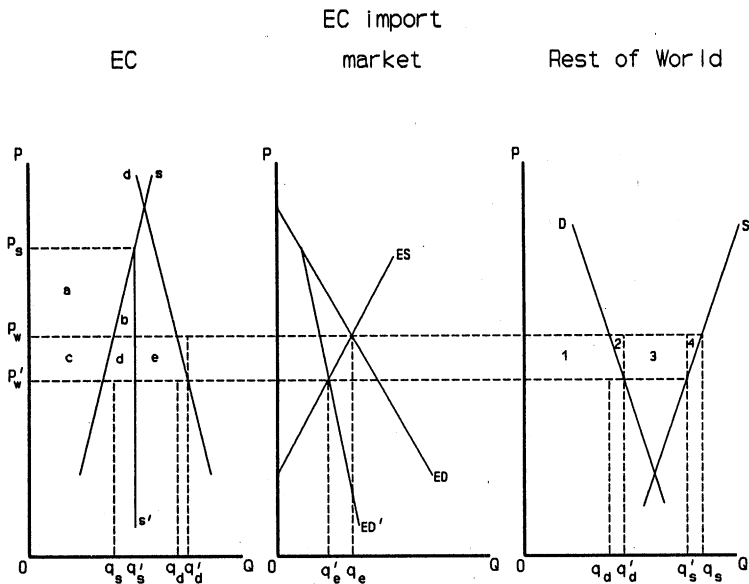
The European Community would like to retain grain support and export subsidy opportunities while pulling oilseeds inside the CAP barriers, but other countries in the GATT have rejected this option. The EC solution has been an oilseed import substitution policy in the form of a processor subsidy which allowed a premium to be passed on to Community producers. This premium was expanded many times in the 1980's and resulted in a doubling of oilseed production in the Community between 1982 and 1987 (Gleckler and Tweeten, 1990a).

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The producer subsidy is illustrated in figure 2. The EC subsidized price P_s in the left panel shifted the domestic supply from s to ss' . EC demand shifted from ED to ED' in the center panel and world price fell from P_w to P'_w which hurts producers in the rest of the world, such as U.S. farmers (loss area 1+2+3+4, right panel). EC oilseed consumers, still able to purchase at the world price P'_w , benefited by area $c+d+e$ and producers by area a compared with a free market equilibrium at P_w . European taxpayers must spend area $a+b+c+d$ to support the policy. Instead of generating levies like other EC imports, the oilseed policy further strains the CAP budget. Even with this producer subsidy, the distortions from not having oilseeds inside CAP barriers are not fully removed. Feed processors purchasing oilseeds at world prices (P_w) continue to find them a bargain compared with highly protected grains.

Figure 2

EC oilseed producer subsidy



In December 1987, the American Soybean Association (ASA) filed a section 301 unfair trade petition against the European Community. The petition alleged that the EC oilseed subsidy constituted a thinly disguised import barrier. The GATT Dispute Settlement Panel ruled in December 1989 that the European oilseed subsidies violate GATT trading rules and discriminate against oilseed imports. In view of this most recent development, the producer subsidy must be eliminated unless multilateral negotiations approve the subsidy as part of a broader agreement that could reduce EC grain export subsidies.

EC policymakers describe a move toward equal levels of market support across all related commodities as "rebalancing." Community leaders would prefer to rebalance oilseeds at high levels without disturbing grain and livestock supports. Such a plan is unlikely given the opposition of exporters including the United States. In recent meetings of the Uruguay Round of GATT, EC negotiators have been pressing a rebalancing proposal which would bring oilseeds behind CAP barriers while concurrently lowering all commodity supports a uniform amount. If export subsidies were cut sufficiently, EC rebalancing might be acceptable to the United States and other exporters.

In the context of negotiations, an acceptable solution might be one in which U.S. producers are at least no worse off after rebalancing. At issue is whether such a rebalancing solution exists. Given present oilseed subsidies, that rebalancing at reduced support levels would probably not leave EC producers indifferent without direct income compensation.

Conceptual Framework

Conceptual models in figures 3 and 4 depict the effects of incorporating oilseeds in the CAP system of variable levies and of lowering market supports for grains. In figure 3, the processor subsidy (assumed to be passed to producers at price P_p) is replaced by uniform market protection for grains and oilseeds. The EC domestic support price P_s , assumed to be at the same level as the former domestic processing subsidy, determines both consumption and production. Demand shifts from free market curve d to dd' , and imports fall from $q_a - q_b$ to $q'_a - q'_b$. Reduced imports lower world price to P_w . European producers are not affected but consumers lose area $a+b+c+d$. The position of European taxpayers changes from

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Figure 3

EC change from oilseed producer support to full market protection

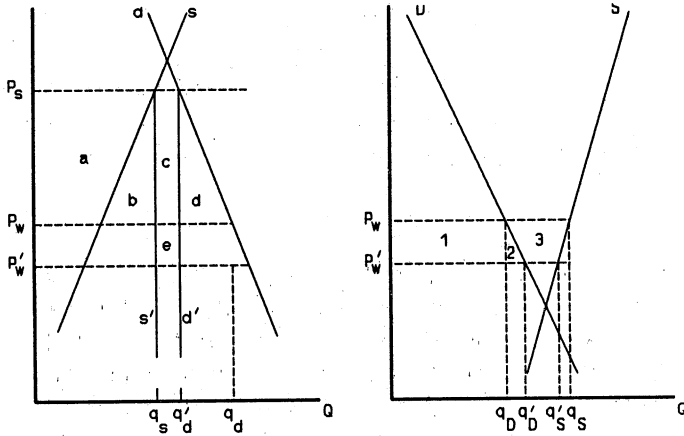
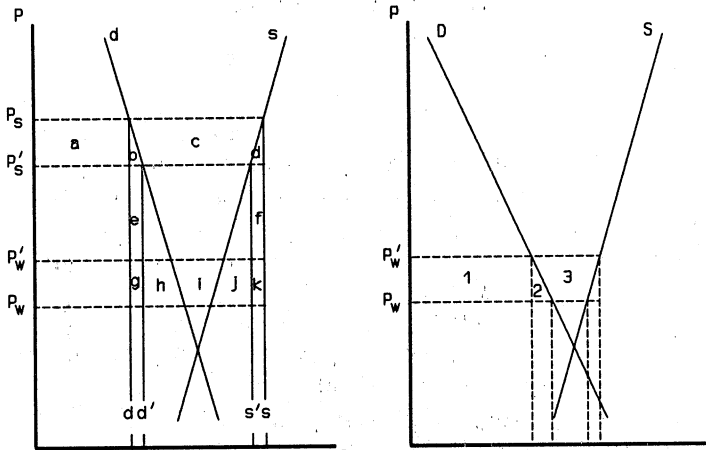


Figure 4

Effects of EC grain export subsidy reduction



paying the area $a+b$ to collecting levies $c+e$. The lower world price benefits U.S. oilseed consumers by area $1+2$, but producers lose area $1+2+3$ in the right panel.

Figure 4 depicts a lower level of intervention in the EC grain market. The CAP support price is lowered from P_s to P'_s . European consumers benefit by area $a+b$ while producers are worse off by area $a+b+c$. Taxpayers benefit by area $b+c+d+e+f+g+h+i+j+k$. The increased receipts evident in figure 3 and the savings in export restitution from figure 4 potentially could enable the EC to directly compensate producer losses with a decoupled payment without further budget expenditures. World grain price rises from P_w with the current policy to P'_w from lower EC grain exports in figure 4 benefiting U.S. producers by area $1+2+3$. U.S. consumers are worse off by area $1+2$.

The conceptual framework does not reveal whether the reduced level of EC oilseed imports and grain exports will balance losses to U.S. oilseed producers (fig. 3) with gains to U.S. grain producers (fig. 4). The simplified partial equilibrium conceptual model does not account for individual country impacts or interactions among commodities. These are best analyzed with a mathematical international trade model. Impacts of rebalancing are quantified for the EC and the United States in the next section.

Empirical Analysis

We estimated the effects of including oilseeds in a rebalanced CAP using a seven-region world trade model incorporating the assumptions of neoclassical trade theory (see Roningen, 1986; Sullivan and others, 1989; and Gleckler and Tweeten, 1990b for descriptions of the model). Data for 1989 were used to initialize the model. Results reflect changes from 1989 conditions and are in 1989 prices. The behavioral coefficients apply to an intermediate-run period of 4 to 5 years, other things equal. The model simultaneously estimates changes in markets for nine commodities: beef, pork, poultry meat, wheat, corn, other coarse grains, oilseeds (principally soybeans, rapeseed, and sunflower seed), oilmeal, and sugar. Substitutability and complementarity among commodities are accounted

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for in behavioral equations. Acceptable solutions in the context of negotiations focus on net change in U.S. producer welfare.

EC rebalancing was represented in the empirical analysis as a uniform percentage reduction in price support of grain, oilseeds, and livestock products with oilseed and oilmeal markets fully incorporated inside CAP barriers. Actual supported prices in 1989 ranged from 115 percent to 166 percent of the world market price (table 1).

The oilseed processor subsidies are assumed to be terminated, bringing producer and consumer prices to the same level realized by producers in 1989 with the processor subsidy. With both the variable levy oilseed revenue and termination of processor taxes adding to government revenue, the CAP fund is much enhanced. The percentage reductions in table 2 and subsequent tables are reductions of consumer and producer prices from levels realized by producers in 1989.

Price support reductions of 0 percent (where oilseed markets were brought inside the barriers without any reduction) to 30 percent were simulated with the model. The 0-percent simulation estimates a possible outcome if the GATT negotiations break down completely. The 15-percent simulation resembles the EC proposals to the GATT in 1990 for

Table 1--1989 actual EC price support as a percentage of world market price

Commodity	Relationship of world market price
	<i>Percent</i>
Beef	115
Pork	120
Poultry meat	138
Wheat	144
Corn	166
Coarse grains	128
Oilseeds	147
Weighted average	140

Source: Unpublished data from U.S. Department of Agriculture.

Table 2--Producer surplus change at different levels of EC rebalancing

Uniform reduction of price support for meat, grains, and oilseeds	Producer surplus change for all commodities		
	United States	EC	Rest of world
<i>Percent</i>	<i>Million dollars</i>		
0	-948	751	-2,539
15	-308	-2,003	-175
20	-84	-2,910	651
25	142	-3,796	1,446
30	368	-4,675	2,281

reducing support. The 30-percent reduction simulates the Hellstrom proposal presented at Brussels in December before negotiations were called off.

As estimates of the producer surplus change in table 2 indicate, U.S. producers are hurt substantially by incorporating oilseeds into the CAP without accompanying reductions in support. However, as European support is reduced between 20 and 25 percent, U.S. producers become indifferent overall to the changes. In other words, the simulations indicate that some EC rebalancing scheme might be acceptable to the United States. The redistribution of benefits among producers would influence their receptivity to such a scheme. EC producers benefit from the simple inclusion of oilseed markets inside the CAP (0-percent reduction). But, as overall import barriers are reduced, EC producers incur substantial losses. The pattern of gains to commodity producers outside the United States and the EC parallel those of U.S. producers over the range of EC support reductions.

Tables 3 through 7 detail the welfare changes from various levels of EC rebalancing. Table 3 (0-percent reduction) indicates that EC livestock producers are hurt by higher prices for the oilseed component of feed mixes. Oilseed and oilmeal consumers lose because they must buy at the

Table 3--Welfare effect of EC rebalancing with 0-percent reduction in uniform support

Item	Producers	Consumers	Taxpayers	Welfare
<i>Million dollars</i>				
European Community:				
Beef	-170	0	38	0
Pork	-266	0	145	0
Poultry meat	-138	0	80	0
Wheat	0	0	-19	0
Corn	0	0	-10	0
Coarse grains	0	0	-12	0
Oilseeds	0	-3,036	3,097	0
Oilmeal	1,325	-3,140	932	0
Sugar	0	0	0	0
Total	751	-6,176	4,249	-1,176
United States:				
Beef	81	4	0	0
Pork	121	-30	0	0
Poultry meat	77	7	0	0
Wheat	-9	6	0	0
Corn	15	28	0	0
Coarse grains	-3	10	0	0
Oilseeds	-648	465	0	0
Oilmeal	-586	617	0	0
Sugar	4	1	0	0
Total	-948	1,108	0	160

high support price. Instead of spending for oilseed producer support, the CAP budget collects a levy on oilseed and oilmeal imports. U.S. livestock producers are slightly better off because of reduced EC exports, but decreased European consumption and imports hurt U.S. oilseed producers.

Table 5 reports effects of a 20-percent rebalanced reduction in EC support, the scheme which most nearly produces overall U.S. producer indifference to rebalancing. The redistribution in benefits to U.S.

producers is evident in this table as livestock and grain farmers gain substantially from reduced EC supports while U.S. oilseed and oilmeal producers are hurt.

The redistribution of benefits may not be as serious as these estimates indicate because of the nature of oilseed production in the United States. U.S. oilseeds are often grown by the same operations that produce

Table 4--Welfare effects of EC rebalancing with 15-percent reduction in uniform support

Item	Producers	Consumers	Taxpayers	Welfare
<i>Million dollars</i>				
European Community:				
Beef	-519	423	63	0
Pork	-845	741	297	0
Poultry meat	-448	36	186	0
Wheat	-754	653	195	0
Corn	-246	299	67	0
Coarse grains	-176	244	-14	0
Oilseeds	-147	-2,618	2,884	0
Oilmeal	1,125	-2,703	829	0
Sugar	7	0	0	0
Total	-2,003	-2,599	4,502	-100
United States:				
Beef	130	-67	0	0
Pork	255	-192	0	0
Poultry meat	218	-140	0	0
Wheat	44	-18	0	0
Corn	133	-69	0	0
Coarse grains	5	1	0	0
Oilseeds	-568	403	0	0
Oilmeal	-527	551	0	0
Sugar	2	1	0	0
Total	-308	470	0	162

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Table 5--Welfare impacts of EC rebalancing with 20-percent reduction in uniform support

Item	Producers	Consumers	Taxpayers	Welfare
<i>Million dollars</i>				
European Community:				
Beef	-629	558	70	0
Pork	-1,041	993	339	0
Poultry meat	-551	484	215	0
Wheat	-1,031	891	280	0
Corn	-334	408	98	0
Coarse grains	-194	292	-16	0
Oilseeds	-199	-2,469	2,809	0
Oilmeal	1,059	-2,555	784	0
Sugar	10	0	0	0
Total	-2,910	-1,398	4,579	271
United States:				
Beef	144	-91	0	0
Pork	303	-250	0	0
Poultry meat	266	-190	0	0
Wheat	66	-28	0	0
Corn	176	-105	0	0
Coarse grains	4	0	0	0
Oilseeds	-539	383	0	0
Oilmeal	-507	529	0	0
Sugar	1	2	0	0
Total	-84	250	0	160

livestock and grain. The losers from including oilseeds in the CAP are the main beneficiaries of European price support reduction in grains and other commodities.

Nearly all categories of EC producers are hurt by rebalancing with the 20-percent or greater reduction in support. The net welfare (deadweight) gains and cash-flow generated by reduced export oilseed processing subsidies would enable direct compensation of producer losses with considerable savings left over. The budget savings of \$4,579 million shown in table 5 represent almost 20 percent of the 1989 CAP budget.

Table 6--Welfare impacts of EC rebalancing with 25-percent reduction in uniform support

Item	Producers	Consumers	Taxpayers	Welfare
<i>Million dollars</i>				
European Community:				
Beef	-746	701	77	0
Pork	-1,223	1,247	373	0
Poultry meat	-651	607	239	0
Wheat	-1,222	1,070	329	0
Corn	-432	516	123	0
Coarse grains	-274	387	-19	0
Oilseeds	-254	-2,320	2,733	0
Oilmeal	994	-2,406	745	0
Sugar	12	0	0	0
Total	-3,796	-198	4,600	606
United States:				
Beef	162	-115	0	0
Pork	350	-307	0	0
Poultry meat	315	-241	0	0
Wheat	78	-35	0	0
Corn	223	-142	0	0
Coarse grains	9	-5	0	0
Oilseeds	-510	359	0	0
Oilmeal	-486	508	0	0
Sugar	1	2	0	0
Total	142	24	0	166

Other rebalancing and support reduction levels (tables 4, 6, and 7) indicate similar EC effects and U.S. producer welfare redistributions. In every case, CAP budget savings are more than enough to compensate EC producers for income loss. Deadweight welfare benefits from rebalancing increase in the EC and United States as EC supports are reduced.

Table 7--Welfare impacts of EC rebalancing with 30-percent reduction in uniform support

Item	Producers	Consumers	Taxpayers	Welfare
<i>Million dollars</i>				
European Community:				
Beef	-857	836	84	0
Pork	-1,413	1,489	402	0
Poultry meat	-752	730	448	0
Wheat	-1,497	1,310	416	0
Corn	-510	625	162	0
Coarse grains	292	434	-26	0
Oilseeds	-295	-2,190	2,661	0
Oilmeal	926	-2,257	706	0
Sugar	15	0	0	0
Total	-4,675	977	4,853	1,155
United States:				
Beef	178	-139	0	0
Pork	396	-362	0	0
Poultry meat	366	-292	0	0
Wheat	101	-45	0	0
Corn	267	-178	0	0
Coarse grains	8	-5	0	0
Oilseeds	-484	339	0	0
Oilmeal	-464	482	0	0
Sugar	0	2	0	0
Total	368	-198	0	170

Conclusion

Our estimations indicate that some level of European rebalancing leaves the overall economic welfare of U.S. producers unchanged. The reduction in CAP supports necessary to bring about the net U.S. producer indifference is between 20 and 25 percent. At that level of reduction, as apparent in deadweight gains, producers in the rest of the world experience net benefits as do U.S. consumers and the total economy.

The redistribution of benefits from U.S. oilseed growers to U.S. livestock and grain producers may be even less of a problem than the model estimates indicate. Much of the redistribution occurs within farming operations producing grains and livestock as well as soybeans.

The 20- to 25-percent range falls within levels of support reduction discussed in the final days of the December 1990 GATT negotiations in Brussels. The feasibility of these rebalancing schemes does not consider the long-term consequences to the United States and other agricultural exporters of having oilseeds permanently behind CAP barriers. However, with rebalancing and a 20-percent reduction in market support, the European Community's CAP budget benefits by \$4,579 million. This figure is enough to directly compensate the \$2,910 million loss to EC producers and still have substantial budget savings. If the EC decides to rebalance without a significant reduction in support for other commodities (0-percent reduction), U.S. oilseed producers ~~were shown to~~ sustain substantial losses.

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