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## European Union

### Trade Policy Monitoring

### Export Subsidies

### 2003

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**Report Highlights:**

Export subsidies are additional support given to producers to supplement a lower price received on the world market when exporting, relative to the domestic price. This type of distortive policy specifically affects developing countries and is not compatible with EU goals for enhancing development. The EU's four largest exports to developing countries include dairy, beverages, cereals, and prepared flour, all of which are aided by export subsidies.

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## Summary

Export subsidies are additional support given to producers to supplement a lower price received on the world market when exporting, relative to the domestic price. This effectively reduces the export price producers are able to take on the world market since they are guaranteed these subsidies; the exporter receives a price equivalent to the higher domestic price rather than the world price. When export subsidies are used in trade with developing countries it is distortive to the local economy in the developing country and also to its export potential. This type of distortive policy specifically affects developing countries and is not compatible with EU goals for enhancing development. The EU's four largest exports to developing countries include dairy, beverages, cereals, and prepared flour, all of which are aided by export subsidies. Many developing countries are also producers of competing products that receive export subsidies, in particular sugar and rice.

## Background

Export subsidies induce two distinct market distortions, in the domestic market for importers as well as in the export market for competitors. Theoretically, export subsidies increase the excess supply on the world market causing the world price to decrease. As a result of the decrease in the world price, the price in the import market declines as well. At the same time, the price paid to the producer in the exporting country increases. The resulting higher price to the exporter decreases consumption in the domestic market and increases supply, therefore increasing exports from that country. The result of the lower price in the importing country causes consumption to increase and supply to decrease; therefore, increased imports are necessary.

Two important effects result from the lower price in the importing country. The first is the resulting decrease in local production, meaning the artificially low price pushes domestic producers out of the market, leaving them unemployed. The second being the lower price received by those who continue to produce, which can be devastating to their livelihood. In addition to pushing existing producers out of the market, export subsidies can inhibit market development of infant industries, particularly in developing countries. The artificially low prices provide disincentives for producers to enter the market and government programs to improve infrastructure and encourage production are often unsuccessful. The result is that the country becomes dependent on the imports.

Furthermore, the increased exports from the subsidizing country and the lower price that can be received for these exports allow the exporter to capture increased market share in import markets. The increased market share comes at the expense of other exporters, often displacing exports from developing countries in the import market. Exporters from developing countries face increased competition, being forced to lower their prices or get out of the market. Exporters looking to diversify into new markets can also have difficulty in penetrating a new market where the price is artificially low due to export subsidies from the EU. Developed countries are able to counterbalance some of these effects; however, many developing countries are left defenseless to the market failures resulting from export subsidies.

## Dairy

Exports on dairy products, specifically skim milk powder (SMP) are arguably one of the most distortive to developing and least developed countries. SMP is the EU's largest export product to developing and least developed countries. To facilitate these exports, the EU used €36.7 million in export subsidies to export nearly one million metric tons of SMP in 2001/02. Of this, 95 percent went to developing countries and over 111,000 metric tons was exported to the least developed countries. The EU subsidizes other dairy products more than it does

SMP, however, the significance of the export subsidies on SMP is due to the fact that SMP primarily is exported to least developed countries.

In addition to SMP, the EU provides massive export subsidies on other dairy products as well. In marketing year 2001/02, the EU provided €324.9 million, €188.6 million, and €402.2 million, respectively on butter, cheese, and other milk products to producers in export subsidies. In total the EU subsidized €952.4 million (over 1 billion USD) solely in export subsidies on dairy products in 2002.

Many developing and least developed countries have become dependent on low priced SMP and other dairy imports from the EU as a primary protein source. Simultaneously, the low cost of the imports has displaced dairy farmers from South Africa to Sri Lanka. South Africa provides a good example of producers that have the potential to be competitive in the local market as well as in the export market. However, due to artificially low prices, the farmers cannot compete in the domestic market much less the export market.

On the opposite end of the spectrum, Sri Lanka is a good example of an infant dairy industry that, due to EU export subsidies, is unable to maintain production. Government programs that provide incentive for dairy farmers to enter production or continue to produce often fail, as even with added incentives to produce, it is not enough to compensate for the low priced imports.

### **Rice, wheat and other cereals**

In the tariff escalation section on rice, it explained the import mechanism that assures rice is milled in the EU. In fact, the EU imports over 666 thousand metric tons of brown rice a year and exports over half that amount (346 thousand metric tons) in milled rice. In the marketing year 2001/02 the EU used €30.3 million in export subsidies for 132.2 thousand metric tons (milled rice equivalent) to facilitate exports of milled rice on the world market.

In terms of brown rice imports, over 60 percent comes from developing countries and a quarter of this is from the ACP countries. Value is added to the raw product in the EU and then the finished, consumer ready product is exported, over a third of which is facilitated through export subsidies. In terms of milled rice exports, the EU exported over 346,000 metric tons in 2002. Of this, 173 thousand metric tons was exported to developing countries, and 50 thousand metric tons went to the least developed countries.

The same story can be told for wheat and other cereals. The EU is a large exporter of wheat and cereals to developing countries; wheat is the EU's third largest export to developing countries following SMP and beverages, which are also aided through export subsidies. In 2002, the EU spent €112.8 million to export 3.9 million tons of coarse grains. In particular, the EU subsidized €8.5 million in wheat alone in 2002. Similar to the market failures in dairy, the export subsidies on rice and cereals undermine the competitiveness of local producers both in the domestic and export markets.

### **Sugar**

Similar to rice and bananas, sugar is also given special treatment in terms of agricultural trade relations. Sugar is negotiated separately in free trade agreements and also in the EU unilateral preference scheme. In the EBA agreement, a tariff rate quota is maintained through 2009 on the import of sugar and similarly in the ACP agreement. In addition to protection through limited market access, EU sugar producers and processors receive large transfers through CAP domestic support and export subsidies. EU expenditures on export subsidies on sugar are larger than any other single commodity.

The EU sugar regime guarantees a high price for the sugar that is produced within production quotas, termed "A and B sugar". Sugar produced in excess of these quotas is termed "C sugar". Sugar classified as C sugar cannot be sold internally and must be exported within the year. Payments in the form of high prices provided to growers and processors by the EU sugar regime finance the production and export of C sugar at prices below its total cost of production. Total export subsidies on sugar for marketing year 2001/02 was €482.8 million on 1.05 million tons.

In addition, the EU grants export subsidies to an amount of white sugar ostensibly equivalent to the quantity of raw sugar that the EU imports under its preferential arrangements, such as from the ACP and EBA countries. The EU excludes these subsidies from the calculation of its total amount of export subsidies that it provides to the WTO (it is not included in the €482.8 million reported above for 2001/02). This amount, reportedly, is approximately an additional 1.6 million tons. The EU did not make WTO reduction commitments for export subsidies on the quantity of sugar imported under preferential access in the Uruguay Round. Through this "re-export" scheme the EU is able to import raw sugar with no tariffs, process it within the EU, and export the finished, white sugar with export subsidies that don't count against WTO commitments, and furthermore, at prices below the cost of production.

Thailand, Australia, and Brazil have brought this case to the dispute settlement body of the WTO, claiming that the EU export subsidy regime does not comply with WTO rules. The EU expends more on sugar export subsidies than its WTO commitments allow, due to excluding export subsidies on sugar equivalent to the amount imported through preferential access. The case also alleges that the export subsidies on sugar allow the EU to export sugar at prices below the cost of production, otherwise known as dumping. The case has finished consultations and the three countries that brought the case have requested that a panel be established.

A consequence of the EU sugar regime to developing countries, the ACP in particular, is that exports to the EU are primarily limited to raw sugar. The EU then processes the raw sugar within the EU, captures the marketing margin from adding value, and re-exports the finished good with export subsidies (see Gain Report E23155). Export subsidies on sugar are detrimental to competing exporters, which are often developing countries. Due to export subsidies currently in excess of €400 per ton, EU sugar is low cost and high quality; it is able to under price other exporters capture increased market share.

## Conclusion

Export subsidies are damaging to developing countries for two primary reasons. The first being that the export subsidy on a product being exported to the developing country can cause the local price in the importing country to decrease. This lower price effectively decreases supply from the importing country, as producers are unable to compete with the artificially low price due to the subsidy. At the same time, the lower price causes consumption to increase. The combined effect of decreased supply and increased consumption will lead to increased imports, which the developing country may become dependent on. The decreased supply will push some producers to exit the market completely.

In addition, export subsidies allow exporters to take a lower price, in some cases lower than the cost of production. This artificially low price that producers can receive allows them to capture market share at the expense of third country exporters, which are often from developing countries.

The combination of tariff escalation (see Gain Report E23155) and export subsidies is detrimental to developing countries working to increase and diversify exports. Tariff escalation inhibits imports of value added goods from third countries in order to maintain the value added process in the domestic country. In this sense, the EU is playing the part of the middleman, capturing the marketing margin by maintaining the tariff escalation scheme that inhibits imports of value added. At the same time, export subsidies facilitate the sale of these value added products abroad.

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