US Agricultural Subsidies and their Implications on Oilseeds and, Oils and Fats Trade

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ABSTRACT

Palm oil is today the leading edible oil traded in the world market, accounting for more than 40% of the total export trade of 17 oils and fats. Although oil palm is widely recognized as the highest yielding oil crop, this does not in any way guarantee that it is the most cost competitive. The reality is that trade distorting measures in the form of agricultural production subsidies and export assistance programmes continue to challenge the competitiveness of palm oil and subsequently, its position as the most competitive vegetable oil.

In highlighting the implications of trade distorting agricultural subsidies, it is clear that farmers' planting decisions in the US are related to the attractive loan rate rather than the market price, thus introducing potential production-influencing effects into the market place.

INTRODUCTION

An agricultural subsidy is normally granted in the form of a production or trade subsidy. In general, domestic support is considered to have the largest effect on production and trade because it provides direct economic incentive to producers to increase or decrease the use of resources, thus affecting the supplies available for exports and demand for imports. Amongst countries in the Americas region, the US highly subsidizes its agricultural sector, both in terms of production and trade under various programmes. In fact, the new US Farm Bill which became law in May 2002 has received criticisms from the US trade partners such as Canada, the European Union, Australia, Brazil and Argentina as it contradicts the US call for freer farm trade. In the other major oilseeds producing countries in the region such as Argentina, Brazil and Canada, the agricultural sector receives little government financial assistance.

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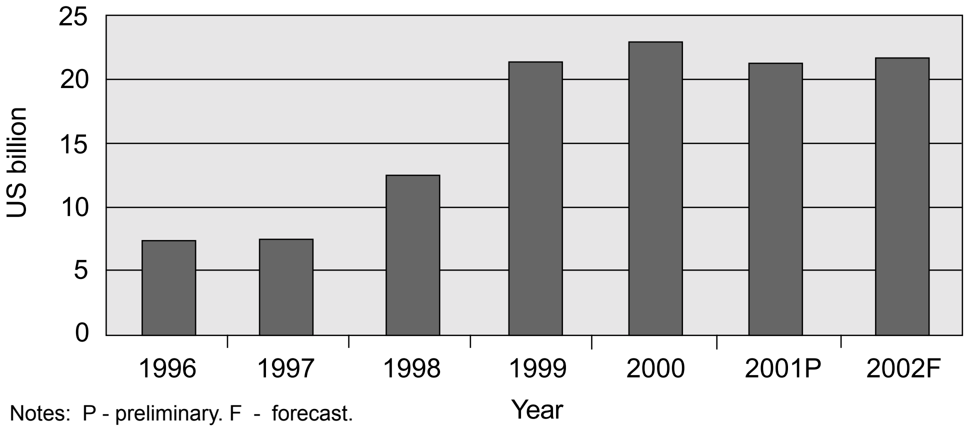
Agricultural Subsidies in the Americas

In Argentina, the agricultural sector receives little direct government financial support. With the exception of a Special Tobacco Fund, the government has no major programme to encourage the production of other agricultural products. In Brazil, the government has gradually phased out supporting the agricultural sector since the inception of the Real Plan in 1994. However, minimum prices are still used as the basis for evaluating production loans given by the Bank of Brazil. In Canada, the government used to provide transportation subsidy to their farmers. The Western Grain Transportation Act (WGTA), passed in 1984, required shippers of grains and oilseeds to pay only a portion of the transportation costs while the government compensated railways for hauling grains from Western Canada to the export points. However, in August 1995, the Canadian Federal Government abolished the transportation subsidy.

US DIRECT GOVERNMENT PAYMENTS

The direct government payments to the US farmers have been increasing over the years, especially since 1997 in response to low agricultural commodity prices. Direct government payments reached the highest level of US$ 22.9 billion in 2000 as a result of the emergency assistance programmes instituted between October 1998 and August 2001 (*Figure 1* and *Table 1*). The US farmers, according to US Department of Agriculture (USDA), collectively received an average of US$ 20 billion/year in direct payments for the period 1998 to 2002, up from US$ 8.8 billion/year during 1990 to 1997. In 2002, the US estimates a total of US$ 21.7 billion in direct payments will be disbursed to farmers as a result of the higher loan rates for commodities (except for soyabean), lower price expectations and the addition of other crops under the new farm bill. Direct government payments include payments made to farmers under the marketing loan programme, loan deficiency payment, production flexibility contracts programme and others.



Notes: P - preliminary. F - forecast.
Source: USDA (June 2002 Forecast).

Figure 1. US direct government payments (1996-2002F).

TABLE 1. US DIRECT GOVERNMENT PAYMENTS, 1998 – 2002F (US$ million)

Item	1998	1999	2000	2001P	2002F
Marketing loan gains	171.1	895.5	1 127.1	2 160.0	2 440.0
Production flexibility contracts	6 000.6	5 045.7	5 048.8	3 881.9	3 013.8
Direct payments	-	-	-	-	5 036.3
Counter-cyclical payments	-	-	-	-	2 246.2
Loan deficiency payments	1 783.0	5 919.1	6 424.5	5 567.7	5 589.4
Emergency assistance	2 818.0	7 803.9	8 492.5	7 111.6	5.5
Others	1 607.3	1 848.9	1 803.5	2 647.2	3 353.7
Total direct payments	12 380.0	21 513.1	22 896.4	21 368.4	21 684.9

Notes: P - preliminary. F - forecast.
Sources: ERS; USDA (June 2002 Forecast).

FARM BILL 2002

The Farm Security and Rural Investment Act of 2002, also known as the Farm Bill 2002, was signed by President Bush on 13 May 2002. The new Farm Bill provides a total of US$ 180 billion in subsidies to US farmers over the next 10 years. The new Farm Bill maintains three major programmes of the 1996 Farm Bill, *i.e.*, planting flexibility, marketing loans and guaranteed annual payments, whilst reviving the target price system, which was abandoned in 1995, to release additional subsidies during hard times. Major provisions in the new US Farm Bill include:

- higher loan rates for most crops (except soyabean);
- fixed direct payments which replaces the production flexibility contract payments. The eligibility for direct payments is also expanded to soyabean, other oilseeds and groundnut under the 2002 Farm Act. The amount of payment is equal to a rate (payment) for the applicable base crop multiplied by the planted area and yield performance for the farm. In order to receive payments on crops covered by the programme, farmers must register with the Farm Service Agency, USDA; and
- a new programme called counter-cyclical income support payments (or target price system). This programme was developed to provide an improved counter-cyclical income safety net to replace the *ad hoc* market loss assistance payments that were provided in 1998-2001. Similar to the direct payments programme, in order to receive payment, farmers must register with the Farm Service Agency, USDA.

Under the US Farm Bill 2002, the oilseeds sector is eligible for assistance through the three major programmes, *i.e.* direct payments, counter-cyclical income support payments and commodity marketing assistance. Previously, under the 1996 Farm Bill, oilseeds, especially soyabean, were only eligible for marketing assistance loans. Hence, under the new law, oilseeds producers are given more financial assistance by the US Government.

DOMESTIC SUPPORT – LOAN RATES, DIRECT PAYMENTS AND TARGET PRICES FOR US CROPS

Over the past 15 years, the commodity loan programmes for major crops have moved away from supporting prices to the provision of loan rates that give income support to producers. The Farm Service Agency, USDA, administers the loan rates. *Table 2* provides some indication of the extent to which US growers of different crops are subsidized. In most crops, the loan rate plus direct payment add up to more than 90% of the target price. The loan rate serves as a floor price for participating farmers in the sense that they can default on their loan and forfeit their crop to the Commodity Credit Corporation rather than sell it in the open market at a lower price.

Nevertheless, what is clear is that these sorts of subsidized measures are a concerted effort deployed to buy votes in the Farm Belt. As a result of such high federal payments, large US farms are driving small farmers to the brink of extinction. Since the last US Farm Bill, hundreds of big farmers and absentee landlords have received

TABLE 2. LOAN RATES, DIRECT PAYMENTS AND TARGET PRICES FOR US CROPS

Commodity	Loan rates			Direct payments	Target price (counter-cyclical payments)	
	1996 – 2002*	2002 - 2003	2004 - 2007	2002 - 2007	2002 - 2003	2004 -2007
Corn (bu)	1.89	1.98	1.95	0.28	2.60	2.63
Soyabean (bu)	5.26	5.00	5.00	0.44	5.80	5.80
Wheat (bu)	2.58	2.80	2.75	0.52	3.86	3.92
Oats (bu)	1.21	1.35	1.33	0.024	1.40	1.44
Barley (bu)	1.65	1.88	1.85	0.24	2.21	2.24
Sorghum (bu)	1.71	1.98	1.95	0.35	2.54	2.57
Cotton (lb)	0.5192	0.5200	0.5200	0.0667	0.7240	0.7240
Rice (cwt)	6.50	6.50	6.50	2.35	10.50	10.50
Minor oilseeds (lb)	0.1050	0.0960	0.0930	0.0080	0.0980	0.1010

Note: *Loan rates under the 1996 Farm Bill.
Source: USDA.

millions of dollars in subsidies. Such subsidies have often been used by the recipients to buy out the small family farms the subsidy programme was originally intended to save. Even Republican law-makers have repudiated the Farm Bill, saying its high subsidies would bring price-crushing crop surpluses but do little to close the loophole for corporate farmers who already receive roughly 80% of the annual subsidies.

The soyabean loan rate had declined from US$ 5.26/bushel to US$ 5.00/bushel (*Table 3*). At the same time, the 2002/03 farm price of soyabean is expected to be between US$ 4.15 and US$ 5.05/bushel. Despite the lower soyabean loan rate, it is anticipated that farmers will continue to benefit through the marketing assistance loan if market prices for soyabean remain low or below US$ 5.00/bushel. However, in view of the estimated lower production and higher demand for soyabean as a result of insufficient supplies of other oilseeds, such as sunflowerseed and rapeseed in the world market for 2002/03, the price of soyabean could be higher this season, thus reducing the farmers' benefits through the commodity loan programmes.

THE ESTABLISHMENT OF NEW SUPPORT PROGRAMMES

The re-introduction of counter-cyclical income support payments (last used in 1995) for major commodities in the new US Farm Bill is another programme intended to support US farmers' income and to offset crop revenue shortfalls due to poor yields or low prices. This has been put in place of the annual emergency assistance bills instituted for the past three years. This programme supports and stabilizes farm income when the effective price is less than the target price set by the government. The effective price is calculated by adding the direct payment to either the loan rate or 12-month average season price, whichever is the higher. If it is below the target rate of US$ 5.80 (for soyabean), the difference will be paid to the farmers. Similar to production flexibility contract programme authorized under the previous Farm Bill, direct payment also increases farmers' income. Although payment does not depend on current production or prices, this programme can potentially affect agricultural investment and enhance crop production as a result of the farmers' wealth through such programmes. In general, all these support programmes cushion the farmers during falling market prices and have little incentive to scale back soyabean planting.

TRADE-EXPORT FINANCIAL ASSISTANCE PROGRAMME

Apart from supporting the production sector, the US also gives financial assistance to their exporters through various programmes (*Table 4*). For oilseeds and their products, export credit programmes are the major export tools used. USDA administers four credit guarantee programmes that help finance a portion of US oilseeds and oilseed products exports. The main programmes of interest are the GSM-102 and GSM-103. The Export Credit Guarantee Programme (GSM-102) guarantees repayment of short-term credits (90 days to three years), whilst the Intermediate Export Credit Guarantee Programme (GSM-103) guarantees repayment of credits of more than three years, but less than 10 years. Under both programmes, USDA's Commodity Credit Corporation (CCC) underwrites credit extended by US banks to approved foreign banks to pay for food and agricultural products sold to for-

TABLE 3. US SOYABEAN: ACREAGE, PRODUCTION AND AVERAGE PRICE

Year	Area (mill. ha)		Production (mill. t)	National average support level (US$/bushel)	Average price to farmers (US$/bushel)
	Planted	Harvested			
1998/99	29.14	28.49	74.60	5.26	4.93
1999/00	29.83	29.32	72.22	5.26	4.63
2000/01	30.07	29.30	75.06	5.26	4.54
2001/02	29.99	29.54	78.68	5.26	4.25
2002/03	29.50	29.14F	77.84F	5.00	4.15 – 5.05F

Note: F - forecast.
Source: USDA (July 2002).

eign buyers. The credit programmes assure US exporters that they will be paid for their products. The minimum annual funding for both programmes is US$ 5.5 billion. USDA views its credit programmes as a commercial programme and not as export subsidies.

GSM-102 is the largest US agricultural export programme. In fiscal year (FY) 2001, GSM-102 allocations of about US$ 4.7 billion were announced to 24 countries and 11 regions, of which a significant share of US$ 4.65 billion was allocated for oilseeds and its products. A total of US$ 0.69 billion was registered for oilseeds sales and US$ 62.4 million for vegetable oils *(Table 5)*. Eligible oilseeds include soyabean, sunflowerseed, cottonseed and groundnut, whilst vegetable oils comprise fully refined soyabean oil, sunflower oil, cottonseed oil, corn oil, groundnut oil and blends of these oils. Unlike GSM-102 and GSM-103, the Supplier Credit Guarantee Programme (SCGP) is designed to provide guarantee for exporters and importers on open account. In place of a letter of credit, SCGP transactions rely on a promissory notes issued by the importer to the exporter. USDA guarantees payment of the note for up to 180 days. In FY 2001, a total of US$ 117 million in soyabean and its products was exported under this programme.

Another programme that is of interest is the Export Enhancement Programme (EEP). Under this programme, exporters are paid cash as bonuses, thus allowing them to sell US agricultural products in targeted countries at below the exporters' costs of acquiring them. The major objective of this programme is to expand US agricultural exports and to challenge unfair trade practices or subsidies instituted by other countries. Under the new Farm Bill, a total of US$ 478 million/year has been allocated for this programme. Besides poultry, the other products eligible for this programme are wheat, barley, sorghum, malt, rice, vegetable oils and table eggs. The US has significantly reduced its use of the EEP since the early 1990s with no export subsidies notified for vegetable oils between 1995 and 1997. Although the Uruguay Round permitted export subsidies amongst others for vegetable oils, the EEP was made applicable only for frozen poultry between 1998 and 2001.

The Food Assistance Programme, PL 480, also known as the Food for Peace Programme, is another programme that is important in the US agricultural trade. The PL 480 Programme includes concessional sales through Title I and donations and grants through Titles II and III. Programmes that are administered by USDA include PL 480 (Title I), Food for Progress Programme, and the Section 416(b) Programme. In FY 2001, the total value of all these programmes was US$ 842 million.

TABLE 4. MAJOR US AGRICULTURAL EXPORT ASSISTANCE PROGRAMME

Programme	Fiscal year 2001	
	Announced	Sales registered
• Export Credit Guarantee		
- GSM-102	US$ 4.7 billion	US$ 3.0 billion
- GSM-103	US$ 193 million	US$ 42.3 million
- Supplier Credit Guarantee	US$ 720 million	US$ 226 million
- Facility Credit Guarantee	n.a	No sales registered
• Export Enhancement Programme (EEP)	US$ 478 million	US$ 6.8 million*
• Food Assistance Programme	n.a	US$ 842 million
- PL 480 (Title I)	n.a	US$ 156 million
- Section 416(b)**	n.a	US$ 630 million
- Food for Progress	n.a	US$ 56 million
• Market Access Programme	US$ 90 million	n.a
• Foreign Market Development Co-operator Programme	US$ 33.5 million	n.a

Notes: * Awarded for frozen poultry only.
** Section 416(b) of the Agricultural Act of 1949.
n.a - not available.
Source: USDA.

TABLE 5. GSM-102 PROGRAMME (US$ million)

Fiscal year	Allocation announced	Registered sales		
		Vegetable oil	Oil meal	Oilseeds
1998	5 793.0	144.0	186.0	625.7
1999	5 121.0	148.5	137.1	665.3
2000	4 550.0	94.6	207.1	744.1
2001	4 653.0	62.4	375.1	686.1
2002*	4 131.0	90.7	257.1	495.6

Note: * As of 31 May 2002.
Source: Oilseeds: World Markets and Trade, USDA (June 2002 Issue).

In general, these programmes are aimed at facilitating US agricultural exports to countries experiencing hard currency constraints that may not be able to purchase US agricultural commodities without credit. Credit also became particularly important in supporting US agricultural exports to several countries during the Asian financial crisis in the late 1990's. Therefore, developing countries which are facing foreign exchange difficulties (which are also incidentally the export markets for Malaysian palm oil) are invariably induced to take up this offer. As a result of the huge annual fund put under such export financial assistance programmes, other major oils and fats exporting countries like Malaysia and Indonesia face stiff competition from the US in order to market their products in the recipient countries.

IMPLICATIONS FOR THE PALM OIL INDUSTRY

How has these support programmes affected trade? In this regard, the trade distorting effects of the US soyabean loan programme results from their impact on plantings. Farmers' planting decisions are related to the attractive loan rate rather than the market price, thus introducing potential production-influencing effects into the market place. The loan programme, which was instituted for soyabean in 1991, has become more important and benefited the soyabean farmers since 1999 owing to the low market prices relative to the commodity loan rate. Despite low soyabean prices, the attractive loan rate continues to encourage farmers to plant and produce more soyabean. As a result of the significant increase in production through such support programmes, coupled with high production in other major producing countries, soyabean is sold at lower prices with a higer quantity demanded, including for exports. At the same time this reduces other countries' commodity exports. In addition, the huge supplies attributed to such governmental support depressed the prices of oilseeds and oils and fats in the global market as witnessed in 1999 and 2000. Improved income growth in the importing countries coupled with their import policy, which favours oilseeds (especially soyabean), have encouraged imports of soyabeans from the US through the various export programmes.

Amongst the countries that are recipient of the US export programmes, such as GSM-102 and PL-480, are Egypt, China, P.R., Hong Kong, India, South Korea and African countries. Apart from the established markets, Malaysia is also expanding to new markets and therefore, the Malaysian palm oil industry has to be more competitive, with producers needing to improve their yield performance and lowering their cost of production.

CONCLUSION

It is an undeniable fact that the US Government will continue to provide support to its agricultural and rural sectors for the foreseeable future as provided under the new Farm Bill. However, both domestic support and export subsidies have indeed become an international pre-occupation in view of the fact that they encourage excess production and distort trade flows. The on-going WTO agricultural negotiations hopes to put in place more stringent rules to the usage of such supports currently practised by developed countries. As members of the Cairns Group, Malaysia and the other group members should work together to eliminate such agricultural support measures in order to create a more level playing field between the developed and developing countries. To sum up, the key questions yet to be answered are: how to accurately identify agricultural supports that are non-trade distorting; how such types of support measures need to be dealt with under the existing trade rules; and finally, how best to limit and further reduce the support measures that do distort both production and trade.

In the era of trade liberalization and globalization, we are looking forward to WTO as an avenue to bring agriculture into the mainstream of trade, with all subsidies eventually being reduced or eliminated. In the meantime, Malaysia as a major producer and exporter has to think of innovative marketing strategies. Also we need to look at developing new users/applications for palm oil in order to bring about more revenue to the industry until all these trade distorting subsidies are removed.

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