# U.S. and EU Farm Policy—How Similar?

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## Introduction

Both the United States and the European Union[1] maintain an array of agricultural policies with goals that range from the traditional objectives of stabilizing agricultural production and supporting farm income to those that have more recently come to the fore, such as assuring adequate nutrition, securing food safety, facilitating rural development, and encouraging environmental protection. This chapter focuses primarily on commodity policy—those programs designed to meet the more traditional goals of supporting production agriculture. U.S. and EU commodity policies address broadly similar goals, but exhibit key differences in their approaches and in the policy instruments each uses. These differences have given rise to numerous trade disputes over the years and have hindered progress in reducing trade barriers, first in the General Agreement on Tariffs and Trade (GATT) and currently in the World Trade Organization (WTO).

In recent years, both the United States and the European Union have made significant changes to their commodity policies. Some observers claim that U.S. and EU policies have become more similar, particularly under the disciplines of the Uruguay Round Agreement on Agriculture (URAA). Efforts to encourage countries to facilitate freer trade in agricultural commodities have led both the United States and the European Union to begin to move their domestic policies toward less trade-distorting programs. Yet differences remain as a result of various factors that have influenced and continue to influence development of agricultural policy in both countries.

We begin our chapter with a description of the basic mechanisms of the U.S. and EU commodity policies that set the stage for a discussion of the ways in which the two countries' commodity policies have become more similar and the ways in which they remain fundamentally different. We conclude with a consideration of those factors that influence the direction of both countries' policies and what they may suggest about future trends.

## Basics of U.S. and EU Commodity Policy

U.S. and EU commodity policy instruments can be categorized generally as either income support or price support, with a residual group of other programs. The main features of current U.S. and EU commodity policy are described below and summarized in tables 1-B and 2-B with additional detail available in the Appendix.[2]

### U.S. Commodity Policy

**Income support** measures in U.S. farm policy include *direct payments, counter-cyclical payments, ad hoc disaster assistance programs, and marketing assistance loans and loan deficiency payments. Subsidized crop and revenue insurance* also support income by reducing risk and increasing expected net returns from insurance.

[1]This paper limits its analysis to the agricultural policies of the European Union, a supranational entity with broad authority for making and carrying out agricultural policy. EU member countries, as sovereign nations, also have some responsibility for agricultural policy, but they are legally limited by EU regulations in the type of support that they may provide to agriculture.

[2]Additional information on U.S. agricultural policy and commodity programs may also be found on the Economic Research Service, USDA, website (http://ers.usda.gov) in the following Briefing Rooms: Farm and Commodity Policy; Wheat; Corn; Rice; Cotton; Soybeans and Oil Crops; Cattle; Hogs; Poultry and Eggs; Dairy; Vegetables and Melons; Fruit and Tree Nuts; and Sugar and Sweeteners.

**Table 1-B—Policies by type and commodity: United States**

| Commodity | Income Support | | | | Price Support | | | | Other | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Marketing Assistance Loans & Loan Deficiency Payments | Direct and Counter-cyclical Payments | Disaster Aid | Crop Insurance | Nonrecourse Loans (with no marketing loan provisions) or Government purchases | Tariffs | Import Quotas (TRQs) | Export Subsidies | Marketing Orders | Land Set-Aside (Conservation Reserve Program) |
| Wheat | X | X[1] | X | X | | | | X[3] | | |
| Corn | X | X[1] | X | X | | X | | | | |
| Other grains | X | X[1] | X | X | | | | X | | |
| Soybeans | X | X[1] | X | X | | | | | | |
| Other oilseeds | X | X[1] | X | X | X | X | X | | | |
| Rice | X | X[1] | X | X | | X | | X[3] | | |
| Sugar | | | X | X | X | X | X | | | |
| Dairy | | X | X | | X | X | X | X | X | |
| Beef | | | X | | | X | X | | | |
| Pork | | | X[2] | | | X | | | | |
| Poultry | | | X | | | X | | X | | |
| Sheep | | | X | | | X | | | | |
| Fruit & vegetables | | | X | X[4] | | X | | | X | |
| Upland cotton | X | X[1] | X | X | | X | X | | | |
| Noncommodity specific | | | | | | | | | | X |

[1]Paid on land previously planted to wheat and other program crops-this land can now be planted to any crop or left fallow.
[2]Payments made in 1999 under Section 32 of Agricultural Act of 1935.
[3]No EEP bonuses have been provided for these commodities since 1995.
[4]Not all fruit and vegetables are eligible.

**Table 2-B—Policies by type and commodity: European Union**

| Commodity | Income Support | | Price Support | | | | | | Other |
|---|---|---|---|---|---|---|---|---|---|
| | Compensatory Payments | Other producer payments | Intervention | Storage aid | Import tariffs | Import quotas (TRQs) | Production/ marketing quotas | Export subsidies | Land set -aside |
| Wheat | X | | X | | X | X | | X | X |
| Corn | X | | X | | X | X | | X | X |
| Other grains | X | | X | | X | X | | X | X |
| Oilseeds | X | | | | | | | | X |
| Rice | X | | X | | X | X | | X | |
| Sugar | | | X | | X | X | X | X | |
| Dairy | | X | X | X | X | X | X | X | |
| Beef | | X | X | X | X | X | | X | |
| Pork | | | | X | X | X | | X | |
| Poultry | | | | | X | X | | X | |
| Sheepmeat | | X | | X | X | X | | X | |
| Fruit & vegetables | | | X | | X | X | | X | |
| Noncommodity specific | | | | | | | | | |

*Direct payments* provide income support to producers based on historical yields and area planted. Payments are available for wheat, feed grains, rice, upland cotton, oilseeds, and peanuts. Farmers are given almost complete flexibility in deciding what crops to plant on the acreage that receives direct payments. Because these payments are not related to current market prices or most farm-level production decisions, they do not have a direct effect on a producer's cropping decisions (i.e., they are "decoupled"). Similar payments called *production flexibility contract (PFC) payments* (sometimes referred to as AMTA payments) were available in 1996-2001 for wheat, feed grains, rice, and upland cotton.

*Counter-cyclical payments* (CCP) are available for covered commodities (wheat, feed grains, rice, upland cotton, oilseeds, and peanuts) whenever the effective price is less than the target price. The target price is set by legislation; the effective price is the amount producers will receive from direct payments and from either market prices or the marketing loan program, depending on whether prices are below the loan rate. The CCP rate is calculated as the difference between the target price and the effective price:

Payment rate = (target price) - (direct payment rate) - (higher of market price or loan rate).

CCPs are paid on the same base production as direct payments. CCPs replace most ad hoc *market loss assistance (MLA) payments*, sometimes referred to as supplemental AMTA payments, that were paid to recipients of PFCs in 1998-2001 to compensate producers for low commodity prices. MLA payment amounts were proportionate to producers' PFC payment amounts.

*National dairy market loss payments* (DMLP) provide a price-based safety net for dairy producers. A monthly direct payment is made to dairy farm operators if the monthly price for a particular class of milk falls below a set price. Payments are limited to the first 2.4 million pounds of milk per year per operation (about the level of production of 135 cows). While almost 80 percent of U.S. dairy farms have less than 100 cows, these farms produce about 27 percent of total milk production.

*Ad hoc disaster assistance programs* have provided direct payments to producers in 10 out of the last 20 years to partially offset financial losses due to severe weather and other natural disasters, or stressful economic conditions, such as low commodity prices or unusual economic events.

*Marketing assistance loans and loan deficiency payments* are available for wheat, rice, corn, grain sorghum, barley, oats, upland cotton, soybeans, other oilseeds, peanuts, mohair, wool, honey, small chickpeas, lentils, and dry peas. Commodity loan programs with marketing loan provisions allow repayment of commodity loans at less than the original loan rate plus accrued interest when the market price is below that level, producing a benefit termed a marketing loan gain. Providing for the marketing loan gain rather than accepting a forfeit of the commodity under loan eliminates the potential effect of supporting market prices through removal of supplies from the market and into government stocks. Producers may elect to receive an equivalent direct payment, called a loan deficiency payment (LDP), in lieu of participating in the loan program.

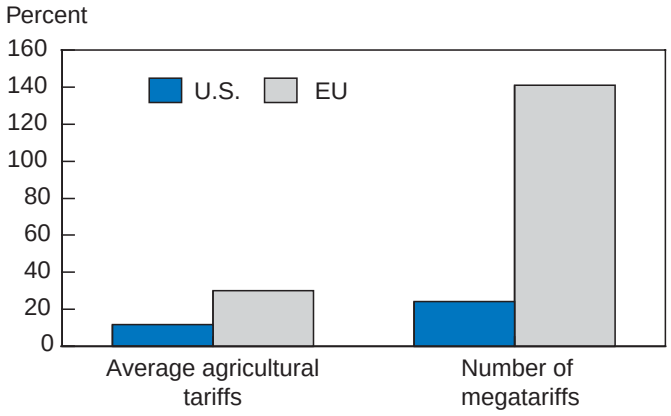
*Crop and revenue insurance*, made available to producers of a variety of crops at subsidized rates, makes indemnity payments to producers based on current losses related to below-average yields or below-average revenue.[3]

**Price support**, although declining in importance in U.S. farm policy relative to income support programs, continues to be provided through commodity-specific programs that set government support prices for sugar, tobacco, and dairy and also accounts for a portion of support received by other producers, through *commodity loan programs*, *government purchases*, *tariffs and tariff-rate quotas*, and *export subsidies*.

*Commodity loan programs* allow producers of specified crops to receive a loan from the government by pledging production as loan collateral. Nonrecourse loans allow producers to forfeit their crop to the government without penalty if the market price at repayment is below the loan rate plus interest. Most commodities have marketing loan provisions (except for sugar, dairy, tobacco, and extra-long staple cotton) to discourage forfeiture. When marketing loan provisions are in effect, loan programs operate as an income–support program rather than as a price–support program.

[3]For additional information on U.S. risk management programs, see the article by Dismukes et al. in this report.

Figure 1-B
**U.S., EU average agricultural tariffs, megatariffs**




Source: Gibson et al.

*Government purchases* support prices of butter, cheddar cheese, or nonfat dry milk by removing enough product from the market to ensure that prices for the milk used to make these dairy products averages at least the same price as the government support price set for milk sold for bottling.

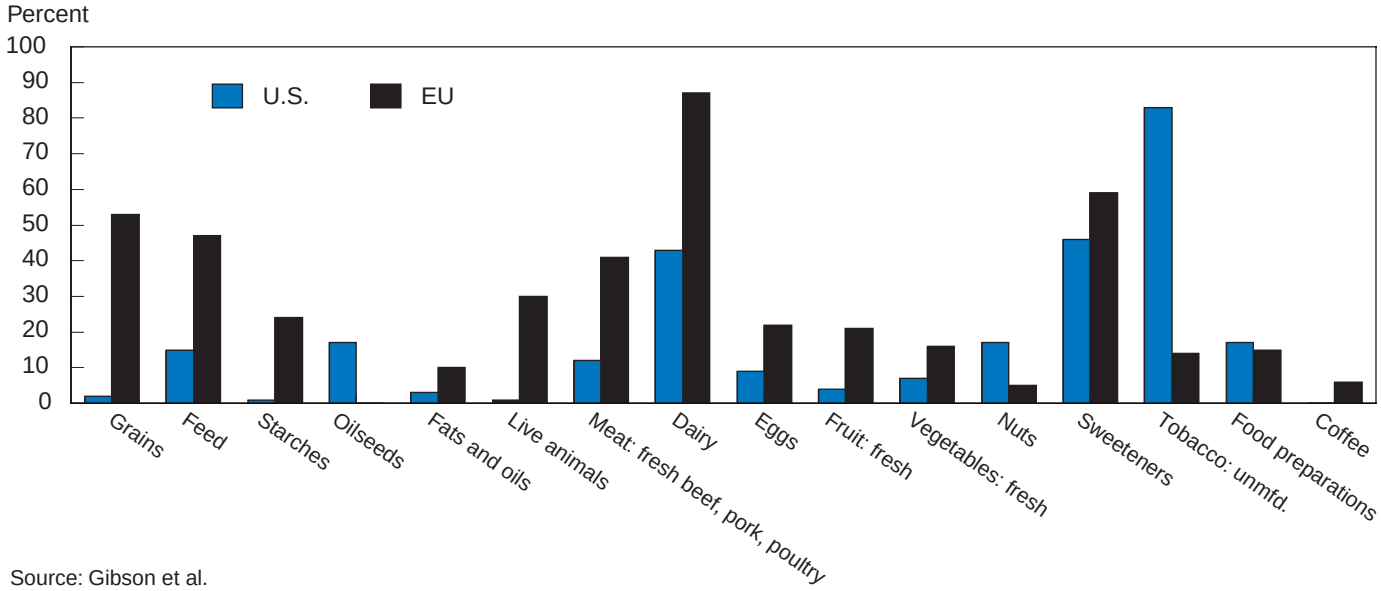
*Tariffs and tariff-rate quotas (TRQ)* provide price support for commodities by limiting imports of lower-priced products. With the exception of a few commodities, trade measures make a minor contribution to U.S. farm policy. The United States has among the lowest average tariffs on agricultural products of all WTO members, with average bound tariffs on agricultural goods of 12 percent (fig. 1-B). Exceptions to these low tariffs include products like dairy, sweeteners, and tobacco (fig. 2-B). The United States has only 24 agricultural "megatariffs," or tariffs in excess of 100 percent (fig. 1-B), and a relatively small number of TRQs, which apply primarily to imports of peanuts, tobacco, beef, dairy, sugar, cotton, and some of their related products.

*Export subsidies* are provided through two programs, the Dairy Export Incentive Program (DEIP) and the Export Enhancement Program (EEP). Under these programs, exporters are awarded cash payments or commodity certificates redeemable for government-owned commodities, enabling an exporter to sell covered commodities to specified countries at prices below those of the U.S. market. Since 1996, limited use of EEP has been made almost exclusively for poultry exports while DEIP has been used at the WTO-negotiated ceiling for skim milk powder and cheese, and to a lesser extent for butter.

**Other programs** include *marketing orders and environmental programs.*

*Marketing orders* are used for dairy and for selected fruits and vegetables. Milk marketing orders, which establish classes and prices for milk of different uses and set minimum prices for those classes, are established to help create orderly marketing conditions. Voluntary marketing orders and marketing agreements for fruit and vegetable products help stabilize market

Figure 2-B
**Average tariff for selected agricultural products, U.S. and EU**




Source: Gibson et al.

conditions by regulating product flow, setting standards for packages and containers, establishing reserve pools for storable commodities, or authorizing production and marketing research and development and advertising.

*Environmental programs* impacting agricultural producers take a number of forms,[4] but the most important are conservation compliance, the Conservation Reserve Program (CRP), the Environmental Quality Incentives Program (EQIP), and the newly established Conservation Security Program (CSP). Conservation compliance provisions of farm legislation require that producers observe certain conservation requirements to be eligible for government payments. CRP is a voluntary program through which farmland owners bid to retire highly erodible and other environmentally–sensitive cropland from production for 10 to 15 years. Farmers receive payments for retiring the land, which also cover the costs of establishing the required permanent cover crop and maintaining specified conservation practices.

EQIP provides technical, educational, and financial assistance to producers to help them implement soil, water, and related natural resource conservation practices on their lands. When implemented, CSP will provide payments to producers for maintaining or adopting structural and/or land management practices that address a wide range of local and/or national resource concerns. CSP focuses on land-based practices and specifically excludes livestock waste handling facilities. Producers can participate at one of three tiers; higher tiers require greater conservation effort and offer higher payments. The lowest cost practices that meet conservation standards must be used.

## EU Commodity Policy

**Income support** measures in EU farm policy include *compensatory payments* and *other direct payments*.

*Compensatory payments* were instituted as part of the 1992 reform package to compensate producers of arable crops (grains, oilseeds, and protein crops) for support price cuts. The payments, although established on a per-ton basis, are made to farmers as a per-hectare payment for area planted to arable crops. The per-hectare payment is based on the average historical yield in the region where they farm. The total area eligible for payments is limited to historical (1989-91) area planted to arable crops or in set-aside.

*Other direct payments* help support the incomes of producers of beef cattle and sheep and will be available to dairy producers beginning in 2005. Eligibility for these payments requires producers to comply with certain supply-limiting features.

**Price support** programs under the Common Agricultural Policy (CAP) include *intervention purchasing* or *product withdrawal, production and marketing quotas, import protection*, and *export subsidies*. Prices for major commodities such as grains, dairy products, beef and veal, and sugar depend on the EU price support system, although with recent reforms price support has become less important for grains and beef. Since 1992, grain support prices have been reduced by 45 percent and beef support prices by 27 percent. Other mechanisms, such as subsidies to assist with temporary storage of surpluses, and consumer subsidies paid to encourage domestic consumption of products like butter and skimmed milk powder, supplement the direct price-support instruments of the CAP in strengthening domestic prices.

*Intervention purchasing* involves purchase by authorities of the surplus supply of eligible products (see table 2-B for list of most eligible products) when market prices threaten to fall below established minimum (intervention) prices. The products are either stored temporarily or exported. In most market conditions, the intervention price acts as a market floor price. Products must meet minimum quality requirements to be accepted into intervention. Policy reforms since 1993 have reduced intervention prices for many commodities and replaced them with compensatory payments. *Product withdrawal,* in which producer organizations withdraw items from the market when prices fall, is limited to a few types of fresh fruits and vegetables.

*Production and marketing quotas* limit overproduction and support outlays for sugar and milk. Quotas help strengthen prices by reducing domestic supply.

*Import protection* has been a crucial feature of the CAP, both to uphold the CAP principle of preference for EU-produced goods and to prevent lower-priced imports from undermining domestic price support mechanisms. Most EU agricultural imports are subject

[4]For more information about U.S. and EU agri-environmental programs, see the article by Bernstein and Cooper in this report.

to high tariffs to ensure that imports do not undercut the prices of domestic agricultural commodities. Although policy reforms have reduced support prices for several commodities, EU agricultural tariffs remain high, averaging 30 percent for all agricultural products, with numerous tariffs in excess of 100 percent (figs. 1-B and 2-B).

*Export subsidies* (also referred to as export refunds or restitutions) are available for most price-supported commodities. Export subsidies help support the domestic price by funding the removal of surplus commodities from the domestic market. A subsidy is paid to exporters to enable them to sell competitively in the world market when the EU internal price exceeds the world market price. Conversely, if world market prices are above EU internal market prices, an export tax may be imposed to limit the outflow of an EU product to stabilize prices for EU consumers. Despite reductions in export subsidies implemented as part of their Uruguay Round commitments, the EU remains by far the largest user of export subsidies among all WTO members.

**Other programs** primarily include supply control through *land set-asides*.

For arable crops, an overall limit on area planted and a mandatory paid set-aside program are used. To be eligible for compensatory payments (described above under income support), arable crop producers must remove a specified percentage (the base rate is set at 10 percent) of their total arable-crop cultivated area from production. Small producers, defined as those whose area planted in arable crops is not sufficient to produce more than 92 tons of grain, are exempt from the set-aside requirement. Beef cattle and sheep numbers eligible for per-animal support payments are also limited and for certain payments, producers must also observe limits on the number of cattle per hectare.

## Major Similarities and Differences

As this review of basic commodity policy mechanisms indicates, some of the two countries' policies have moved in similar directions in the last decades. Significant differences in their approaches to farm support remain, however, particularly in their relative reliance on income support and price support.

Both the United States and the European Union have reduced the use of price support for several commodities, replacing at least a part of their price support with income support through direct payments to producers. The European Union remains more reliant on market price support than the United States, however.

The United States' direct payments (formerly production flexibility payments) are decoupled from current production and prices, and the new counter-cyclical payments are decoupled from current production (although linked to current prices). The EU's compensatory payments for arable crops and livestock headage payments are not related to current prices, but are linked to current area planted and livestock numbers, although subject to limitations based on area caps and ceilings on eligible animal numbers.

In the United States, planting flexibility was a companion reform to decoupling support payments from production. Producers gained the freedom to plant almost any crop or leave land fallow without losing eligibility for direct payments. EU producers have a limited form of flexibility that allows them to receive payments if they continue to plant arable crops or put land in set-aside.

With reductions in support prices and government purchases, both countries have reduced the need for surplus disposal mechanisms. The United States' use of export subsidies in recent years has been limited essentially to dairy products and poultry. The EU continues to use export subsidies for many price-supported commodities, although WTO obligations have required them to reduce subsidy levels. In recent years, beef intervention stocks have continued to pose problems of surplus disposal for the EU, although part of this problem is due to the weakening in demand and policy actions in response to the BSE (mad cow disease) crisis.

The two countries also differ in their reliance on border measures, including tariffs and tariff-rate quotas, to provide support for domestic agriculture. Although both maintain tariffs, the European Union's are higher, on average, and there are a greater number of tariffs over 100 percent. The European Union also makes heavier use of export subsidies across a wider range of commodities.

Overall, while both countries provide moderately high support to their agricultural sectors relative to other developed countries, the European Union maintains a

**Table 3-B—U.S. and EU farm policies—Key similarities and differences**

| Similarities | Differences |
|---|---|
| ***Price Support*** | |
| Both have reduced their use of direct price supports in recent years. | EU maintains direct price support for many commodities, intervention price acts as market floor price.<br>The U.S. maintains direct price support for only dairy, sugar and tobacco; marketing loan rates, which determine marketing loan gains and loan deficiency payments, do not act as market floor prices. |
| ***Income Support*** | |
| Both have increased their reliance on income support through direct producer payments. | EU compensatory payments are partially decoupled (based on current area planted or livestock numbers, but subject to limits).<br>U.S. primary direct payments program is decoupled from current production (based on historical entitlements); U.S. counter-cyclical payments are decoupled from current production, but linked to current market prices; U.S. marketing loan program provides income support coupled to current production and prices. |
| ***Planting Flexibility*** | |
| Both systems feature a degree of planting flexibility for producers of program crops. | EU producers must plant arable crops or participate in land set-asides to receive the payment.<br>U.S. producers who receive direct payments and counter-cyclical payments are not limited, with minor exceptions, in the crops they may plant; marketing loan gains and loan deficiency payments are tied to production of specific crops. |
| ***Supply Control*** | |
| Both countries have some form of supply control. | EU uses production/marketing quotas for dairy and sugar, mandatory arable crop set-aside and limits on area planted to arable crops, limitations on numbers of beef cattle and sheep eligible for payments, and cattle stocking limits.<br>U.S. has eliminated use of set-aside programs for supply, land retirement continues only for environmental purposes; supply control through marketing allotments and "payment-in-kind" programs are authorized for sugar. |
| ***Surplus Disposal*** | |
| Both countries have reduced chronic surpluses and large stocks. | EU continues to engage in surplus disposal through export subsidies for a number of commodities and subsidies on domestic consumption for a limited group of commodities.<br>U.S. makes limited use of export subsidy programs (DEIP) to remove surplus. |
| ***Border Measures*** | |
| Both countries maintain tariffs on agricultural products.<br>Both countries have some tariffs greater than 100 percent (megatariffs).<br>Both countries use export subsidies. | EU agricultural tariffs average 30 percent.<br>U.S. agricultural tariffs average 12 percent.<br>EU maintains 142 megatariffs. U.S. maintains 24 megatariffs.<br>EU provides export subsidies across a wider range of commodities and accounts for 90 percent of all WTO-notified export subsidies; EU may also impose export tax (infrequently used) to stabilize domestic market prices.<br>U.S. provides export subsidies primarily for dairy and poultry; U.S. prohibited by Constitution from taxing exports. |
| ***Total Support*** | |
| Both the U.S. and EU maintain moderately high support levels for agriculture (as measured by PSE). | EU support higher than U.S.; EU relies to a significantly greater extent on market price support than U.S. |
| Both countries devote significant budget outlays to supporting agriculture. | EU budget outlays for agricultural support higher (in $US) since 1987. |
| Both have been shifting basic policies away from production-linked price support toward less directly linked programs, but both continue to provide substantial coupled support to parts of agricultural sector. | As measured by 1998 WTO notifications, EU provides more coupled or partially-coupled (amber or blue box) support, U.S. provides more decoupled (green box) support. |

higher overall support level, has higher budget outlays for agricultural support, and provides more support that is coupled or partially coupled to production than the United States (see "Comparison of U.S. and EU Support and Protection").

## Factors Influencing Commodity Policy

The factors that have shaped and will continue to shape agricultural policy formation in the United States and EU may be the best predictor of whether the two countries' commodity policies will grow more similar or more different over time. Those factors include historical differences in the policy context, constraints enforced by budget limits and trade agreements (including planned enlargement of the EU), and pressures from new issues, arising from increasing public concerns with environmental impacts of agriculture, food safety and quality, rural development, and a changing farm structure.

## Historical Differences in Policy Context

Current commodity policy in the United States and the EU is the outcome of the evolution of developments and policy changes of the previous 30-plus years. The roots of the current U.S. farm policy may be found in the commodity price support programs established by the New Deal in the context of the Depression of the 1930s. In the face of dramatically low prices for farm goods, policymakers devised programs that would support farm income while at the same time ensuring availability of food at affordable prices for workers in the nonfarm economy. For much of the time since then, policymakers responded to repeated occurrences of downward pressure on prices, caused by above-average production and/or reduced global demand, by bolstering prices.

The EU's CAP, in contrast, arose from conditions that prevailed in Europe in the years following World War II, when food security was a major concern for a population whose memories of wartime food shortages were still fresh. The CAP was designed to address the problems of an agricultural sector characterized by small and fragmented farms, poor productivity, and low farm incomes. It remains today primarily a domestically-oriented policy whose main objective is to support farm income.

Since the early days of the CAP, EU agricultural productivity has soared, spurred by high support prices as well as technological advances.[5] Food security is no longer a pressing concern for the EU; production of most agricultural commodities has grown beyond the level required to meet the EU's consumption needs, in part because consumption growth has been slowed by high support prices. As a result, since the 1960s the EU has shifted from being a net food importer to one of the world's largest net exporters of wheat, sugar, meat, and dairy products. Managing surpluses has replaced food security as a major preoccupation of EU agricultural policymakers.

At the same time, however, the EU's position as a net exporter, coupled with the realities of the constraints on subsidies imposed by the URAA, has led policymakers to be increasingly concerned with the competitiveness of EU agriculture. The need for improved competitiveness underlay the additional support price cuts under the agricultural policy reforms adopted in 1999 under the "Agenda 2000" program.

In the United States, by the 1980s government-supported prices had limited international marketing opportunities, while increasing global supplies had undercut domestic supply control efforts. Government stocks of program commodities were steadily increasing, and record agricultural spending coupled with high Federal budget deficits emphasized the need to rein in agricultural support. The farm legislation of 1985 and 1990 maintained the traditional combination of price supports, supply controls, and income support payments, but introduced changes that moved farmers toward greater market orientation by reducing price supports, replacing price support for some crops with marketing loans that allowed markets to clear, introducing greater planting flexibility, and giving more attention to developing export opportunities for U.S. farm products.

The 1996 Farm Act produced a dramatic change in the character of Federal assistance to farmers. The legislation introduced a system that allowed nearly complete planting flexibility and promised continued government efforts to enhance access to international markets. To ease the transition to reduced reliance on income support, the act provided for decreasing fixed

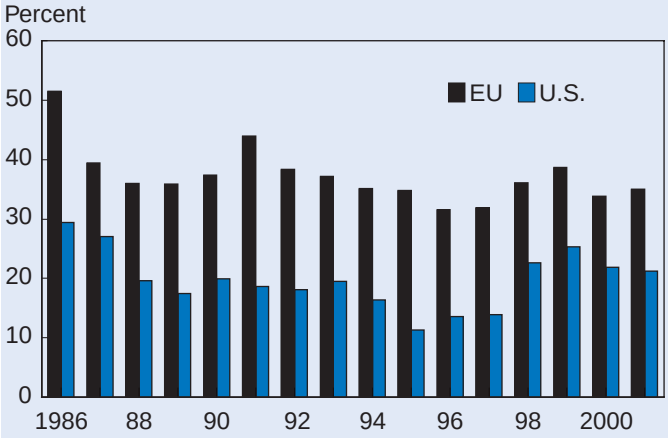
[5] For a discussion of how EU agricultural productivity has changed over the years, see the article by Leetmaa *et al.* in this report.

# Comparison of U.S. and EU Agricultural Support and Protection

A convenient method for comparing relative support levels of U.S. and EU farm policy is the Organization for Economic Cooperation and Development's (OECD) Producer Support Estimate (PSE), a broad indicator used to evaluate policy measures that provide support to agriculture. The PSE is an indicator of the monetary value of transfers from consumers and taxpayers to agricultural producers arising from policy measures that support agriculture (OECD). The PSE can be used to characterize the value of farm policy and support to producers in each country, expressed either in total value terms or as a percent of the value of production (percent PSE). The PSE captures support provided to 13 common commodities that account for 66 percent of the value of U.S. agricultural production and 63 percent of EU production. The main commodities not included in the PSE are fruit, vegetables, nuts and other specialty crops, cotton, tobacco, and peanuts.

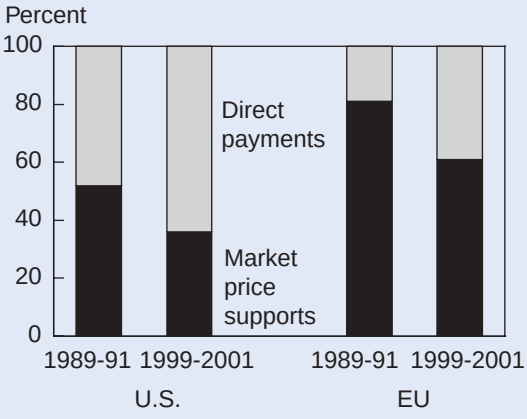
- The average percentage PSE for 1999-2001 was 23 percent for the United States, and 36 percent for the European Union, compared with an OECD average of 33 percent.
- A comparison of percentage PSEs for both countries (fig. 3-B) shows that for the past 16 years, the EU's agricultural sector has consistently derived a greater share of total receipts from government support than has U.S. agriculture.
- Market price support, which includes commodity loans, tariffs, and other price support for the United States, and intervention price support and tariffs for the EU, is the largest component of EU total producer support (fig. 4-B). Despite increased use of direct payments, the EU relies to a greater extent on market price support than does the United States. The U.S. shares of market price support and direct payments are nearly the opposite of the EU's; market price support accounts for roughly 61 percent of total producer support in the EU, and about 36 percent in the United States.
- EU income support is dominated by payments based on current planted area or animal numbers (arable crop compensatory payments and livestock headage payments). U.S. income support is more heavily reliant on payments for production (marketing loan gains or loan deficiency payments) or payments based on historical entitlements (in 1999-2001, these were primarily PFC payments and market loss assistance payments). Input subsidies for crop insurance, energy, and irrigation are a small share of total producer support in the United States.
- In the United States, producers of milk, grains, and oilseeds are the greatest beneficiaries of measured support, while livestock producers receive relatively little support (fig. 5-B). EU producers of grain receive the greatest share of EU support, followed by milk and beef producers (fig. 5-B).
- Government expenditures provide another indication of support to agriculture. They are a narrower indicator than the PSE, because they do not reflect support provided by consumers in the form of higher prices. However, they can capture the value of some government policies that affect commodities not covered by the PSE.
- Government outlays on agriculture have grown in both countries since 1990 (fig. 6-B). EU outlays on agricultural support have grown at a steadier rate, while the U.S. experienced large run-ups in support spending beginning in the late 1990s. Expressed in a common currency, EU outlays on agricultural support have exceeded U.S. outlays since 1987.

Figure 3-B
**U.S. and EU percentage PSE**




Source: OECD, Paris.

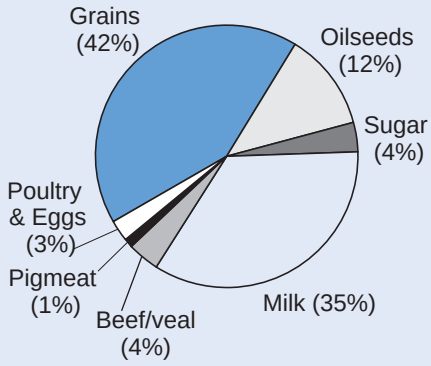
Figure 4-B
**Changing composition of U.S., EU PSE**



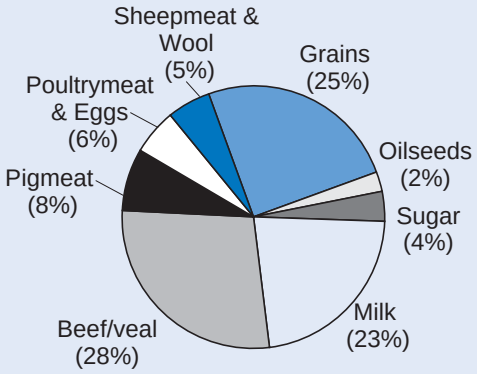

Source: OECD, Paris.

Figure 5-B

**Agricultural support (PSE) by commodity, 1999-2001[1]**




**United States**



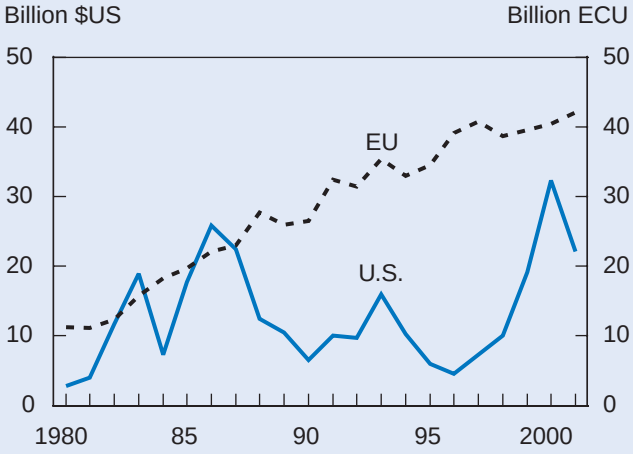

**European Union**

[1]Percent of support for commodities for which PSE is calculated.

Source: OECD, Paris.

Figure 6-B

**Expenditures on agricultural support, national currency**




Source: USDA, FSA; European Commission.

- A comparison of U.S. and EU agricultural support as reported to the World Trade Organization (WTO) provides further information on how the two countries support their agricultural sectors. The WTO categorizes agricultural domestic support policies according to the extent of their trade distortion: green box policies are considered minimally trade-distorting, amber box policies are considered trade-distorting and subject to negotiated reduction commitments, and blue box policies are considered trade-distorting but, because they meet certain criteria that limit their impact, are exempt from reduction commitments. In 1999, the latest year for which these reports, or "notifications," are available for both countries, the EU continued to provide a higher level of trade-distorting support through the amber and blue boxes (table 4-B).
- Reliance on trade measures clearly differentiates their policies as well. As measured by average tariffs applying to agricultural products, the U.S. agricultural sector is less restrictive of agricultural trade than the EU (table 5-B). The EU also relies to a greater extent than the United States on megatariffs (tariffs in excess of 100 percent) on agricultural products. The EU continues to rely heavily on export subsidies, while the United States has substantially reduced their use.

**Table 4-B—U.S., EU domestic support levels, 1999**

| | United States | European Union |
|---|---|---|
| | *Million $US* | |
| Amber box | 16,862 | 49,933 |
| Blue box | 0 | 20,638 |
| Green box | 49,749 | 20,783 |
| Total | 66,611 | 91,354 |

Source: WTO notifications.

**Table 5-B—U.S., EU trade measures**

| | United States | European Union |
|---|---|---|
| Average agricultural tariff (%) | 12 | 30 |
| Agricultural megatariffs (number) | 24 | 142 |
| Average export subsidies, 1995-2000 (mil. $) | 84 | 5,530 |

Source: Gibson et al.; Leetmaa.

income support payments that were no longer tied to production decisions. With the return of low prices for many commodities, a series of emergency ad hoc aid payments were made from 1998 through 2001, primarily in the form of additional direct income support payments. The 2002 Farm Act, while increasing support levels from those legislated in the 1996 Act, continued planting flexibility and basing program payments on historic production.

## Constraints Enforced by Budget Limits and Trade Agreements

*Budget limits*. Fiscal constraints have been important in both countries, although less so in the United States in recent years. The need to reduce government expenditures in the face of persistent fiscal deficits made it difficult for U.S. legislators to increase spending on agricultural programs in the 1990s. However, budget surpluses in the early stages of the debate on the 2002 Farm Act combined with low market revenues among other things, led to significant increases in funding committed for agricultural programs. Budget concerns may again become important to U.S. farm policy in light of renewed fiscal constraints.

Supporting agriculture has also required large outlays from the EU; the CAP now accounts for about 50 percent of the EU budget (based on 2000 appropriations) but has required as much as 70 percent in earlier years.[6] The agricultural budget guideline sets an upper bound (that has been exceeded occasionally) on total EU outlays on agricultural programs. The EU also faces a unique circumstance in the anticipated budget effects of the impending enlargement of the Community. Unlimited price support with the entry of several new agricultural producing members would be unsustainable (Leetmaa et al., 1998). As EU support has shifted from a near-total reliance on price supports, which are funded primarily by consumers, toward producer payments funded by taxpayers, the capacity of the budget to provide support to producers may be further strained.

*Trade agreements.* Trade is important to the agricultural sectors of both the United States and the European Union. Increases in production of many commodities have outpaced the growth of domestic demand. With continued growth in productivity, both countries will have to find outlets for additional agricultural production if they are to maintain strong agricultural sectors. This need has strongly influenced U.S. agricultural policy changes since the 1980s, when policy increasingly emphasized market-driven production decisions by reducing price support, eliminating supply controls, and providing planting flexibility for many program commodities. EU agricultural policy has more recently reflected the need to improve export competitiveness through reductions in support prices for some commodities, although it has expanded supply control to limit support expenditures.

Efforts to achieve more open global agricultural trade through multilateral and regional trade agreements have increased the influence of changes in world market conditions on U.S. agriculture. At the same time, these agreements impose constraints on traditional U.S. commodity support policies. The URAA resulted in the first meaningful multilateral agreement covering agricultural trade, forcing policymakers in both countries to take into account the constraints imposed by the URAA.

The URAA was arguably a more significant discipline on EU domestic commodity policies than on U.S. policies. The EU's Agenda 2000 reforms acknowledged explicitly the importance of the URAA, citing the need to reduce support prices to comply with Uruguay Round commitments (Commission of the European Communities, 2001). In contrast, the obligations imposed by the URAA did not require major changes in U.S. agricultural policies. U.S. amber box domestic support did not exceed 29 percent of its ceiling in any of the first 3 years of URAA implementation, and export subsidies for all relevant commodities were well within ceiling levels. Orden et al. (1999) noted that "in the United States international negotiations functioned more as a source of farm policy continuity than as a force for policy change…. In the course of the 1995/96 congressional farm bill debate, the URAA was almost never mentioned."

The 2002 Farm Act explicitly acknowledges the constraints imposed by the Agreement on Agriculture on future U.S. farm support. The act requires the Secretary of Agriculture to reduce expenditures on commodity programs to ensure that such expenditures do not exceed such allowable levels.

As the two countries continue to provide for the needs of the farm sector while complying with the tightening

[6]It should be noted that the EU budget reflects a narrow set of expenditures of a supranational entity with limited responsibilities, of which agricultural support is one of the most significant.

limits on trade-distorting support, they may seek to provide support increasingly through policies that provide funding for environmental or rural development programs, which may qualify for exemption from WTO reduction commitments. The new WTO negotiations on agriculture may encourage this tendency, if they are successful in achieving further reductions in trade-distorting domestic support, tariff, and export subsidy policies. Trade agreement disciplines that limit the potential differences in level and type of trade-distorting programs between the United States and EU may lead to greater convergence in commodity policy approaches and could contribute to less contentious trade relationships and trade agreement negotiations.

### Pressure From New Issues

New issues, including environmental concerns, food safety and quality, rural development, and changing farm structure, are increasingly shaping, or promising to shape, commodity policy in both countries. In the United States, environmental concerns are increasing pressures to reduce the negative effects of agricultural production on the environment. The 2002 Farm Act increased authorized support for conservation programs by about 80 percent. Outbreaks of food-borne illness and increased awareness of food safety issues are giving rise to public demands for policy changes in the EU. As nonfarm activities increasingly dominate the economic life of many rural communities, policymakers in both countries may need to look beyond traditional commodity support programs to encourage rural development. The current U.S. farm sector is highly diverse, with farms varying by size and type of operation, commodities produced, regional situation, operator age, tenure, and degree of household dependence on farm income. This diversity makes it difficult for a uniform farm policy to effectively address the very different needs of groups within the U.S. farm sector.

The EU's Berlin European Council of 1999, which adopted the Agenda 2000 policy changes, endorsed policies aimed at producing a "multifunctional, sustainable, and competitive agriculture" (Europa). The 1992 EU CAP reform introduced payments tied to environmental considerations, including payments to livestock producers that required less intensive livestock production. The Agenda 2000 policy reforms reinforced this development, strengthening the link between producer support payments and environmental protection requirements. Agenda 2000 also reflected increased concern with providing for a dynamic rural economy, and introduced or expanded a number of programs aimed at promoting rural development. The EU, through its policy of "modulation," allows member countries to shift some funding from commodity support to rural development programs, including agri-environmental programs and programs aimed at promoting increased diversification.

Concerns related to the safety and quality of food have occupied EU officials for the last several years, as mad cow disease, outbreaks of food-borne illnesses, and the foot-and-mouth disease (FMD) crisis shook Europeans' confidence in public institutions. Changes in commodity policy aimed at promoting more extensive livestock production, combined with stricter standards on animal feeds and meat hygiene, are seen as reducing conditions associated with intensive livestock production that may give rise to animal diseases, poorer food safety, and pollution (Europa).

Traditional domestic support and trade concerns will undoubtedly continue to play a primary role in commodity policy direction in both the United States and the EU, and trade goals and constraints will likely have the most influence on whether the two countries' commodity policies become more similar. However, the pressure of public demands for more attention to such issues as environmental impacts and food safety in agricultural production, some of which have yet to be fully reflected in commodity policies, will likely gain increasing influence in both the United States and the European Union.

## Conclusions

The United States and European Union share many of the same goals for farm policy, and in some cases, have moved toward similar approaches to meeting those goals in recent years. Their commodity policies remain different, however, in significant ways—particularly their differing reliance on income versus price support, their use of surplus disposal and supply control, and their reliance on border measures. The two countries face similar pressures from tight budgets, trade constraints, and increasing public connection of agricultural policy with issues beyond traditional goals for supporting production agriculture. Whether these pressures will lead to similar policy responses remains to be seen. So far, they have not done so consistently, in part because levels of public

interest and pressure have not been the same in both countries, reflecting differences in current conditions and recent experiences.

In the United States, debate on the impacts of the 2002 Farm Act will continue to influence the future of U.S. farm policy as budget outlays, trade negotiations, environmental and consumer concerns, and production issues fuel discussions of appropriate and effective agricultural programs. In the EU, new reforms arising from the 2002-03 mid-term review of the CAP are spurring a similar debate (see "Latest EU CAP Reform May Increase Similarities"). In the midst of these debates, the future direction of farm policy in neither country is clear, but while significant differences will undoubtedly remain, some of the discussion suggests the possibility that U.S. and EU farm policies could be headed in a similar direction.

## Latest EU CAP Reform May Increase Similarities

In June 2003 the EU adopted a comprehensive reform of the Common Agricultural Policy (CAP). The latest reform alters the way support is provided to producers of arable crops (grains, oilseeds, and protein crops), rice, nuts, potatoes for starch, dried fodder, beef, sheep, and milk. All other commodity regimes, such as fruit and vegetables, potatoes, and sugar, remain unchanged.

Main features of the reform agreement include:

- A direct income, or single farm, payment based on historical payments for arable crops, rice, beef, and sheep, will replace existing payments (mainly compensatory and livestock headage payments) that are tied to current production of commodities. Under an earlier reform, dairy producers will receive a direct payment in partial compensation for dairy support price cuts beginning in 2004. The dairy payment will be included in the single farm payment after 2008.
- To minimize risks of land abandonment, member states may opt to retain support coupled to production of arable crops and beef for some proportion of direct payments. The maximum proportion of payments that may remain coupled to production varies by commodity.
- Intervention price support for rye is eliminated, while support prices are reduced for rice and dairy products (butter and skim milk powder).
- A new carbon credit of 45 euros/hectare will be available to encourage the production of energy crops, limited to 1.5 million hectares.
- The reform expands a program ("modulation") established under Agenda 2000 that allowed member states to reduce payments for larger farms and use the savings to fund rural development programs. All member states will be required to implement such programs.
- The policy changes reflect an increased emphasis on quality, with a new quality premium available for durum wheat and producer incentive payments designed to improve the quality of agricultural products and production processes.
- Support will be available to help farmers adapt to environmental, animal and plant health, animal welfare, and occupational safety standards. Support will also be provided to defray the cost associated with improving the welfare of farm animals.
- Producer payments will be contingent on compliance with environmental, food safety, and animal health and welfare standards.
- Farmers will have increased flexibility regarding what they can produce, with the exception of explicitly excluded products (perennial crops, fruits and vegetables, or crops for which they receive payments under certain sectors that which have not yet been reformed or for which there are restrictions on new plantings).

The new features adopted in this agreement bear many similarities to U.S. commodity programs, particularly in two areas: emphasis on income support decoupled from current production and focus on the interactions between agriculture and the environment. Both U.S. policy and the new EU policy feature—for a group of commodities--direct payments based on historical payment levels and not linked to current production. The EU also joins the United States in providing farmers with greater production flexibility. Both systems increase the policy focus on protecting the environment through programs on working lands. In addition, cross-compliance, which requires producers to comply with environmental regulations and standards to receive direct payments and has been required in the United States for some time would now be mandatory in the EU. Finally, both countries continue to maintain commodity-specific income support—the EU through its partial retention of coupled payments and the United States through the marketing loan program.

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