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THE EUROPEAN ECONOMIC COMMUNITY'S
VEGETABLE OIL TAX PROPOSAL:
A CASE STUDY OF TRADE CONFLICT

by

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THE EUROPEAN ECONOMIC COMMUNITY'S VEGETABLE OIL TAX PROPOSAL: A CASE STUDY OF TRADE CONFLICT

> "Exports are the lifeblood of the American soybean industry. In 1980 American soybean producers saw over 55 percent of their production exported at a value of $8.6 billion, the largest of any commodity and fully 20 percent of total U.S. agricultural exports. Strong export markets are essential to the prosperity of our industry. Unfortunately, we stand to lose much of our export market for soybeans because of protectionism on the part of Spain and the European Community..." 1/

This statement by Allan Aves, immediate past chairman of the American Soybean Association, reflects the concern of U.S. farmers over the E.C.'s proposed import restrictions of U.S. soybeans and soybean products. This recent issue poses a serious threat to the trading relationship between the E.C. and the U.S.[2/]

The size of the world soybean market has increased fourfold in the last twenty years, for a variety of reasons. Consumer demand for meat (especially red meat and poultry) has risen quickly in traditional European markets, as well as in the centrally planned and middle income developing country markets. This increase in demand can be attributed to population growth, rising incomes and the increasing popularity of high

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1/ Allan Aves, Testimony of the American Soybean Association. Submitted to U.S. Senate Governmental Affairs Subcommittee on Energy, Nuclear Proliferation and Government Processes. Urbana, Illinois, Oct. 16, 1981.

2/ Seeley Lodwick, Undersecretary of Agriculture for International Affairs and Commodity Programs. Remarks prepared for delivery in a Seminar on the EEC in DesMoines, Iowa. Reported in the Washington Agricultural Record, Vol. 11, No. 37, Oct. 2, 1981.

protein diets. During this time, other feedstuffs have been subject to high levies, while soybeans have enjoyed an absence of major import restrictions.3/ The U.S. presently exports soybeans and products in 123 countires worldwide.4/ The U.S. held a market share of about 80 percent of world trade in soybeans in 1978.5/ The largest buyers of U.S. soybeans are Japan, with 19 percent of the total exports (1975-78) and the European Economic Community with 48 percent of total exports (1975-78).6/

The Dillon Round of GATT negotiations (1960-62) was held to discuss the effects of the formation of the EEC and its new common external tariff on previous GATT agreements. Tariff concessions were also exchanged.7/ During these negotiations the E.C. agreed to bind tariff levels at zero for soybeans and soybean meal. A 4-8 percent ad valorem duty is levied on soybean oil for industrial use; 10-15 percent against oil for edible use.8/ These restrictions on oil act as an incentive

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3/ Philip Paarlberg and Alan Webb, "International Trade Policy Issues." USDA: Agricultural-Food Policy Review: Perspectives for the 1980's, USDA, Washington, D.D., April 1981, p. 99.

4/ Alan Holz, "World Oilseeds and Products Outlook." Paper presented at the 1980 Agricultural Outlook Conference, USDA, Washington, D.C., Nov. 5-18, 1979, pp. 232-233.

5/ Alan Webb, Fats and Oils Outlook and Situation, 1981, USDA, Washington, D.C., 1981.

6/ Webb, op. cit., p. 3.

7/ USDA Foreign Agricultural Service, GATT Tariff Conference and American Agriculture, Washington, D.C., May 1962, pp. 1-2.

8/ Cathy L. Jabara, Trade Restrictions in International Grain and Oilseeds Markets: A Comparative Country Analysis, USDA Economics and Statistics Service, Foreign Agriculture Report #162, Washington, D.C., January 1981, p. 13.

to process the beans within the E.C. Hence, U.S. exports to the E.C. are mainly in the form of raw soybeans.[9/]

In the past several months, particularly since considering the practical ramifications of the enlargement issue (i.e., the accession of Greece, Spain and Portugal), the E.C. has been exploring means to offset the increased FEOGA expenditures which this accession will cause. Some proposals include a production tax on imported and domestically produced vegetable oils or a minimum import price system such as that already in effect in Spain, along with re-export provisions similar to Spain's (this will be explored furhter later in this paper.) Most of the proposals to raise revenue for the accession involve some costs to U.S. export industries.[10/]

One of the most visible of these proposals is that of an imposition of a tax for domestic consumption of all vegetable oils, part of which would be related for olive oil consumption. This tax of $10.80 per 100 kg. of vegetable oil would be levied on virtually all sectors of the food market, both imports and domestically produced goods, including feedstuffs containing vegetable oils.[11/] The E.C. stands to gain from the policy by reducing the trade diverting effects of imported soybeans on its feedstuff, dairy and vegetable oil sectors. However, many nations, the U.S. in

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9/ Webb, op. cit., p. 3.

10/ Stephen C. Schmidt, "Enlargment of the European Community: Plans, Concerns and Implications." Unpublished paper, University of Illinois at Urbana-Champaign. Department of Agricultural Economics, Fall, 1981, pp. 22-24.

11/ Schmidt, op. cit., p. 22.

particular, claim that the policy would violate GATT, in spirit if not in letter. They threaten to retaliate, claiming that their domestic industries stand to be harmed as a result of the policy.

Upon processing, raw soybeans are the source of two distinct products: very high protein meal and oil. "A 60-pound bushel of soybeans yields, on the average, 11 pounds of oil and 47 to 48 pounds of meal."12/ This high protein meal is used as feed for livestock and poultry; the oil is used primarily for margarine, shortening, cooking, and salad oils.13/ The proposed vegetable oil tax aims to reduce some of the trade displacement that each of these products cause.

Soybean meal, at 44 percent protein, is one of the best protein sources for livestock feed. Its most common substitutes include fishmeal, peanutmeal, sunflowermeal, canola, cottonseedmeal, low protein tapioca (cassava), corn gluten meal and feedgrains.14/ In addition, the E.C. has been using skim milk powder as a protein feed supplement, in an effort to reduce the incredible dairy surpluses in the Community. Soft wheat, of which the Community runs a persistent surplus, is also used as a feedgrain. High cereal and skim milk powder prices (resulting from support policies) have reduced consumption of these high priced indigenously produced feed products in favor of cheaper soymeal, mainoc and corn gluten.15/ As a result, the E.C. has expressed an interest in tariffs and quotas on soybeans and meal to make their supported products more competitive.

12/ Penelope C. Cate, "U.S.-Spanish Agricultural Trade Problems: Soybeans and Soybean Oil." Congressional Research Service, Library of Congress, Food and Agriculture Section; Environment and Natural Resources Policy Division, Washington, D.C., Oct. 8, 1981, p. 1.

13/ Cate, op. cit., p. 3.

14/ Cate, op. cit., p. 3.

15/ Schmidt, op. cit., p. 26.

The vegetable oil tax would do just that. This would reduce skim milk powder surpluses, end displacement of domestic feed grains, and reduce dependence on protein feeds imported from outside the Community.[16/]

This last is an important point. The E.C. consistently attempts to become and remain self-sufficient in most products consumed in the Community. Especially since the rise in demand for red meat and high protein diets, the Community has attempted to promote self-sufficiency in feedstuffs - oilseeds in particular. Presently, the E.C. supports four types of oilseeds - rapeseed, sunflowerseed, flaxseed and soybeans. Because of climatic conditions, only rapeseed and sunflowers are grown in any significant amounts. Ninety percent of production is rape, with sunflower production accounting for most of the remainder.[17/] As a result of the supports, rape production has increased from 1.2 MMT in 1979 to 2.0 MMT in 1980, to a projected 2.1 MMT in 1981.[18/]

Despite the Community's efforts toward self-sufficiency in feedstuffs, it is doubtful that they will be able to achieve this goal. Skim milk powder surpluses are expensive; the E.C. is now focusing efforts on reducing dairy surpluses in general through co-responsibility and supplementary levies and support price reduction.[19/] Consequently, this source of feed protein is unlikely to be available in the long run. Secondly, though soft wheat is a good source of energy calories in feed, it must

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16/ Paarlberg and Webb, op. cit. p. 99.

17/ Schmidt, op. cit., p. 31.

18/ Frank Tarrant. From telephone conversations on Nov. 17, 1981, USDA Foreign Agriculture Service, Washington, D.C.

19/ A.E. Buckwell, Dr. Harvey, K.A. Paiton and K.S. Thompson. "Some Development Options for the Common Agricultural Policy," Unpublished paper, University of Newcastle Upon Tyne, 1981, p. 4.

be used with a good protein source to provide a balanced livestock diet. In addition, the feedgrains grown within the Community are supported and, consequently, very expensive. Thirdly rapemeal is not a perfect substitute for soymeal. Rapemeal can only be used for about five percent of a ration because of its chemical makeup.[20/] Nor can rapemeal and sunflowermeal be produced in sufficient quantities due to cost considerations. Currently, the E.C. is about 15 percent self-sufficient in protein meals. According to USDA projections, it is not likely to achieve much more than this percentage in producing its own feedingstuffs.[21/] Since it is likely that feedgrains grown within the E.C. will continue to be supported at high prices, and since under the tax proposal all imported meal prices will rise, it can be expected that the relative price of soymeal will remain low. This, coupled with soymeal's extremely high protein content and the points outlined above, suggest that the E.C. is not likely to decrease its meal imports substantially. Soymeal is likely to continue to be a major source of export revenue for American farmers.

20/ In a conversation with Frank Tarrant of the USDA Foreign Agricultural Service, he pointed out that rapeseed could only be used as 5% of a feed ration. Protein content needs for livestock vary according to type and use of the animal--from around 10% for beef cows to 10-15% for lactating cows. In order to find out about this restriction, I talked to Professor Larry Chase, of Cornell's Animal Science Department. He said that rapeseed has gluco-sinnalates, which can upset the digestion in pigs and cows if present in too large quantities in the feed. In addition, rapemeal has a bitter taste--so animals won't eat feed with too much rapemeal. Hence, the reasons for the restrictions. However, Mr. Chase pointed out that plant breeders had come up with a meal from rapeseed that has had its bitterness and much of the gluco-sinnalates bred out of it. This meal is called canola meal. It has been grown successfully in Canada, and will no doubt be available in the E.C. before long.

21/ Tarrant, op. cit.

The real threat to American soybean export revenue is animed at soyoil, in the form of the tax outlined above. Although imports of soyoil are already restricted, this vegetable oil tax will be even more limiting. The purposes of limiting the amount of oil imported are: a) to reduce dairy support expenditures, b) to raise revenue for FEOGA expenditures, which are expected to rise considerably when Spain and Portugal join the E.C., and c) to encourage the use of olive oil rather than other kinds of oil.[22/]

According to some analysts, the chronic dairy surplus in the E.C. is largely a function of the lenient import policies on oils and fats. These policies have resulted in low margarine prices and consequent increases in the consumption of margarine at the expense of higher-priced butter. Studies examining the substitutability of the two products, and consumption trends of oils in general suggest that these analysts' reasoning may well be spurious. Further, estimates of the price elasticity of demand for both butter and margarine are about -.03.[23/] If this is the case, the vegetable oil tax would have little effect on reducing butter surpluses in the E.C. As in the case of skim milk powder, massive reform of the dairy support program under the CAP is more likely to solve that problem than would a tax on oil imports.

The accession of Greece, Portugal, and Spain is likely to add considerably to the Community's FEOGA expenditures. The addition of Spain alone is expected to add 600 million EUA for the Guarantee section and

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22/ Schmidt, op. cit.

23/ Schmidt, op. cit.

200-250 million EUA for the Guidance section.[24/] All three are poor countries with backward agricultural sectors. Major products include fruits, wines, olives and olive oil. Plots of land are small and inefficient - mechanization is not very widespread. Both the products grown (and, consequently, supported) and the structure of agricultural production in the area mean large outlays of support from the Community's funds. Money must be raised to offset the effects of the accession, especially considering the already critical condition of the Common Agricultural Policy and the European Agricultural Guidance and Guarantee Fund (FEOGA). This tax is being proposed in an effort to offset these large financial burdens.[25/]

The third purpose of the tax is to encourage the use of olive oil rather than other kinds of oils. With the accession of Greece to the E.C. in January of 1981, the olive oil market in the E.C. moved from a position of structural deficiency to one of potential surplus.[26/] With Spain and Portugal joining over the next few years, "an olive oil slick is about to spread all over Europe."[27/]

To cope with the huge surpluses of olive oil, the E.C. plans to encourage olive oil consumption in two ways. First, the vegetable oil tax will make other oils more expensive relative to olive oil. Secondly, the E.C. will provide a consumption subsidy on olive oil. Taken together, these two should have the effect of increasing olive oil consumption at the other oils.

24/ Economic and Social Committee of the European Communities. The Community's Relations with Spain, Brussels, 1979, p. 53.

25/ Schmidt, op. eit.

26/ Cate, op. cit., p. 11.

27/ ________. "Cold Winds From The South," The Economist, Nov. 1, 1980, p. 63.

Regardless of the reasons for the proposed tax, many countries, the U.S. in particular, feel that this policy is in direct violation of the zero tariff bindings negotiated in the Dillon Round. In September of 1981, the Food and Agricultural Organization's Committee on Commodity Problems stated that it regarded this proposal as "a protectionist move and contrary to the international agreements reached at various forums such as GATT."[28/]

There is a particular issue in world trading circles that brings to bear on the acceptability of such a measure. This is the U.S.'s long standing but little publicized dispute with Spain concerning the Spanish soyoil quota. Spain requires substantial amounts of soybean meal for its large livestock and poultry industries. It produces only about one percent of its beans domestically, and imports most of the remainder from the U.S.[29/] Spain imports raw soybeans for crushing to support its processing industries. It uses the meal gleaned from processing for its livestock and poultry industries.

The soybean oil produced from these industries competes with olive oil, as well as sunfloweroil. To protect these two industries, Spain began to restrict sales of soyoil in their domestic market by way of a quota in 1969. As production of sunfloweroil and olive oil has increased since then, Spain has been continually lowering the quota of soyoil available for domestic consumption. At the same time, she has been importing

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28/ Schmidt, op. cit.

29/ Sheldon S. Hauck, "Statement of the National Soybean Producers Association," submitted to the Senate Subcommittee on Energy Nuclear Proliferation and Government Processes of the Senate Committee on Governmental Affairs, Urbana, Illinois, Oct. 16, 1981.

ever increasing amounts of soybeans for processing. The difference between the amount produced from processing the quota allowed for consumption is subsidized for export by $100 per metric ton.[30/] This soyoil competes with U.S. soyoil exports. Spain is now the world's fourth largest exporter of soyoil.[31/]

After bilateral negotiations with Spain about the issue failed, the U.S. lodged a formal complaint with the GATT Council in 1979. A panel, made up of representatives from Hungary, Switzerland, and Uruguay reviewed the case. The U.S. charged that Spain was violating Article III of the GATT agreement. This article requires that countries not discriminate against imported products in favor of domestically produced ones. The contention was that by not having similar quotas on other oils, (especially olive and sunflower oil) Spain was discriminating against American soyoil. Further, Spain was harming U.S. soyoil exports as a result of the policy and competing unfairly by subsidizing their exports.

The Panel ruled in favor of Spain in November of 1980. Their reasoning was that soybean oil processed from imported soybeans is a domestic product, and that it is significantly different from other kinds of oils. (Since the oils are different, the "discrimination" was justified in the Panel's view.) Further, the U.S. would have to prove injury to its soybean industry in the form of declining exports as a direct result of the policy in order for the policy to be deemed unfair. Since U.S. soyoil exports have actually been increasing since the policy took effect, and because Spain exports to non-traditional U.S. markets like Morocco and Turkey, this injury would be difficult to demonstrate.[32/]

30/ Hauck, op. cit.

31/ Cate, op. cit., pp. 5-6.

32/ Cate, op. cit., pp. 6-7/

The U.S. disputed the Panel's findings. The U.S. consequently filed a brief with the GATT Council to be heard on November 3 of 1981. The results of that hearing are not yet known.

Some analysts feel that the real issue is that "given the EC's anticipated surplus of olive oil as a result of the enlargement, in conjunction with the GATT Panel's preliminary findings on Spain's marketing quotas on soybean oil, some observers have expressed the fear that some modified form of the harsh discriminatory policy toward soybean oil currently practiced in Spain may be adopted EC-wide."[33/] If the GATT Council upholds the Panel's decision, this would lend legitimacy to the same type of policy for the E.C. as a whole.

As could be expected, several soybean-related groups within the U.S. have expressed grave concern over the proceedings. They decry a potential loss of a $4 million-plus export market for soybeans.[34/] Certainly, since the E.C. receives 48 percent of our soybean exports, the effect of the tax would no doubt be felt. But would the U.S. soybean industries really be damaged substantially by the policy?

The question is difficult to assess. The evidence seems to point, however, to the negative--that after a brief period of readjustment, the effects on U.S. industries will most likely be minimal.

First, as described above, it is doubtful that the restrictions will result in significant decreases in the amount of soybean meal imported by the E.C. Given the protein content and relative prices of the E.C.'s alternatives, soybean meal is still their best option. Since consumer

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33/ Cate, op. cit., p. 11.

34/ Hauck, op. cit.

demand for livestock products is not likely to fall off in the future, soybean meal is going to be needed for a long time to come.

Secondly, the E.C.'s share of soybean exports is falling: it is down to 48 percent in 1978 from 59 percent just a few years earlier.35/ Other countries, such as Japan, are consistent importers. In the Tokyo Round of multilateral negotiations for GATT, Japan agreed to bind its tariff on feed-quality soybeans at zero. This agreement alone represents $770 million (1976 base trade value) of increased trade for the U.S. "It is impossible to calculate or predict the value of this trade concession (in the future). Most observers value this concession highly and feel that a similar "free" binding on soybeans obtained from the European Community during the 1962 Dillon Round, and sustained since then, has been partially responsible for that market's huge growth."36/

In addition, twenty other nations offered bindings in the Tokyo Round--with a value of $265 million for soybeans and oil. Though this doesn't necessarily guarantee new trade, it does represent insurance against duty increases.37/

Thirdly, though the outlook for soybean oil may seem particularly grim, this product has enjoyed rising popularity in recent years. In 1960, soybean oil enjoyed only a 30 percent share of world fats and oils trade. In 1978, it had grown to hold a 40 percent share.38/ India, the

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35/ Webb, op. cit.; Paarlberg and Webb, op. cit.

36/ James P. Houck. "Agricultural Trade: Protectionism, Policy, and the Tokyo-Geneva Negotiating Round," American Journal of Agricultural Economics, Vol. 61, No. 5, Dec. 1979, p. 868.

37/ Houck, op. cit., p. 871.

38/ Webb, op. cit., p. 2.

People's Republic of China, and the USSR have all emerged recently as major importers of soybean oil.39/ The Wall Street Journal reports that within 10-15 years, China could become a leading customer for soybeans--importing up to 4 MMT within 15 years for dairy and hog industries, as well as for oil.40/ In addition, one of the most demanded commodities in PL-480 and other similar programs is soyoil. Though these sales start out on a concessional basis, there is reason to believe that the commodity will continue to be purchased as these countries develop further.41/

Thus, though the E.C.'s decision could have a substantial impact, it seems that there are alternative markets to absorb the resultant diverted trade is the E.C. implements the tax.

The E.C. may well temper its decision, in light of possible retaliation on the part of the U.S. The U.S. has claimed that if the E.C. restricts soybean imports, the U.S. will not necessarily wait for redress under GATT, but rather would take quick retaliatory action.42/ Though the Block administration has not specified what form this retaliation might take, one can guess what the probable actions might be. Three particularly sensitive trade issues involve the E.C.'s incredible milk surpluses. These areas of contention with the U.S. are skim milk powder products, cheeses and casein. The U.S. could choose, for example, to flood the market with skim milk powder--thus driving down the price of E.C. skim milk powder exports. It could reclassify casein so that this

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39/ Holz, op. cit., p. 241.

40/ Connie S. Harrison. "Group Seeks to Export Soybeans to China along with U.S. Hog-feeding Practice," The Wall Street Journal, Sept. 24, 1980, Section 2, p. 42.

41/ Kenneth L. Robinson. From class notes taken Fall, 1981, Cornell University, Department of Agricultural Economics, Ag. Ec. 351.

42/ Lodwick, op. cit.

E.C. product would now be subject to import restrictions. Additionally, in the Tokyo Round of negotiations, the U.S. agreed to quota increases worth $66.0 million (1976 base) for European specialty cheeses.[43/] The U.S. could decide not to honor this negotiated quota. Although the dollar value of these retaliatory measures is uncertain, their effects would no doubt be felt by the E.C. The E.C. would be wise to consider future trading relations with the U.S. when arriving at a decision about its proposed vegetable oil tax.

In mid-October of 1981, the European Economic Community Commission announced that they were no longer considering the vegetable oil tax at this time, but that future discussion would probably be in order when Spain joins the E.C. (projected to be in 4-5 years). The question is whether the E.C. will once again reinforce its protectionist tendencies, or whether the Community will respond to the pressures of enlargement by adapting the much-beleagured CAP.[44/] We can be sure that the issue will be followed closely by the U.S. and other GATT members.

The proposal of a vegetable oil tax is a recurring one within the E.C.--it has been discussed in various forms since 1960. It is an attractive option for the Community because it is a way of raising revenue and a method to decrease the surpluses of Community supported agricultural goods such as dairy products and feedgrains. It is not clear, whether this tax would be successful in either of these two goals. It is clear, however, that the U.S. and other members of GATT consider the tax a protectionist policy which is contrary to previous agreements.

43/ Houck, op. cit.

44/ Cate, op. cit.

U.S. soyoil exports would seem to be harmed more than any other product under such a policy. On closer inspection, it seems that there are alternative markets to be explored for this product. It is likely that the eventual effects on the U.S. from such a policy would be fairly small. The effects on the E.C. would be more substantial--increased livestock prices, a continuation of incredible surpluses stemming from agricultural policy that provides inappropriate incentives, and disruption of their trade. Other solutions, such as reform of the CAP system, would seem to be a much more effective means of coping with present problems, as well as new difficulties brought about by the accession of Greece, Portugal and Spain.

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