

## **King Cotton's Subsidies under Attack in the WTO as Agricultural Negotiations Stumble Along**

### *The WTO Ruling*

The World Trade Organization (WTO) focused attention on the large subsidies the US government gives to cotton farmers by rejecting the US claim that they do not impact cotton production. The interim ruling accepted Brazil's argument that US subsidies exceed the internationally negotiated limit and thereby lose the protection of the WTO agricultural agreement's "peace clause," which has shielded them from challenges up to now. The ruling also found that Brazilian cotton farmers had been harmed by the US subsidies, including export credit guarantees. The Bush administration said it will appeal the WTO interim panel decision unless the final decision, due to be announced on June 18, differs from the interim ruling. Informed observers say this is unlikely.

### *The US Government Position*

The US has always argued that its production flexibility payments and direct payments are so-called "green box" (not trade distorting) subsidies, as opposed to "amber box" commodity-specific subsidies. Payments to farmers, the US maintains, are "decoupled" from production; farmers are paid according to the acres they plant and the cotton they produced in the past. Amber box subsidies are protected from challenges and countervailing duties by the Uruguay Round agricultural agreement as long as they do not exceed 1992 levels. These limits do not apply to green box subsidies. The US also claims that its export credit guarantees for the cotton program are not a prohibited export subsidy. USTR Robert Zoellick reacted to the WTO ruling by warning Brazil and other G20 countries that a decision to litigate rather than negotiate would not produce positive results.

### *Brazil's Argument*

The government of Brazil argues that US subsidies to cotton farmers and traders has a direct and significant impact on cotton production and export, lowering world prices and negatively impacting Brazilian cotton farmers. This is the first time a domestic agricultural subsidy has been challenged in the WTO. Brazil cited the increase in US world market share from 20% in 1999 to 40% in 2004. The US gave cotton farmers \$12.5 billion from mid 1999 to mid 2003 and these farmers produced \$13.9 billion worth of cotton. The 2001-2002 cotton crop was worth \$3.08 billion and the US paid subsidies of about \$4 billion.

Brazil charges that the seven different subsidies given to US cotton producers cause serious prejudice to Brazil's interests through: a) significant price suppression, b) increase in the US world market share of cotton, and c) an inequitable US share of world cotton trade. The Brazilians pointed out that cotton production increased from 13.1 million acres in 1998-1999 to 15.5 million acres in 2001-2002 and that the US cotton export market share increased from 17% in 1998-1999 to 42% in 2002-2003. US exports more than doubled while the dollar revalued by 154% against a basket of currencies of other cotton producers. During the same period, Brazilian cotton producers lost \$478 million from depressed prices.

According to Brazil, the export credit guarantees extended to cotton farmers under three Commodity Credit Corporation (CCC) programs also constitute a subsidy. The CCC

guarantees cover \$4 billion in cotton exports. These credits cannot be secured in the market and do not vary with risk, and their premiums do not cover long-term operating costs, including losses. In addition, Step 2 payments are made only to domestic cotton users and exporters. As these are mandatory requirements, Brazil argues, the payments amount to a prohibited subsidy.

### *The Outlook for Cotton*

The outlook for cotton prices is not good for producers. On the supply side the area planted has increased, genetically modified cotton has increased from 2% in 1996-1997 to 20% today, and world stocks are high. Demand has been relatively weak because of the slow growth in the world economy. A study by the International Cotton Advisory Committee shows that 73% of cotton producers receive direct income or price support in 14 countries. If cotton subsidies were lifted the price of cotton would be 73 cents per pound rather than the current 42 cents. The cost of production, not including rent and seed, ranges from 68 cents per pound in the US to 21 cents in Burkina Faso. Brazil estimates it lost \$640 million this year due to low prices. Other countries, including Argentina, Colombia and India, also were affected. With the US Farm Bill providing for continued high subsidies the outlook for cotton is not good for producers worldwide.

### *Agricultural Negotiations*

The WTO ruling may eventually bring changes to US cotton subsidies but real and permanent change will happen only in the context of wider agricultural negotiations in multilateral organizations. The agricultural negotiations in the WTO Doha Round are stalled, at least temporarily. The deadline for establishing a framework for agricultural negotiations is July, which means progress must be made in ongoing talks in May. However, Brazil, as a member of the G20 (group of developing countries), has circulated a paper objecting to the "Blended Formula" of tariff reductions proposed by the US, the EU and other developed countries. It maintains that the formula is biased in favor of the tariff structures of its proponents and would impose an onerous burden of tariff reduction on developing countries.

USTR Robert Zoellick responded that those opposed to the formula should "figure out a way to come up with what they would like." The US complains that Brazil and other critics of the formula have yet to suggest any substantive ideas and that they need to provide for market access while dealing with the import sensitivities of other countries (especially the EU and Japan). The EU tried to get things moving on May 10 when it announced its agreement that all countries must set an end date for the abolition of agricultural export subsidies. The Cairns Group and the G20 agreed to draft a proposal to reduce agricultural support and tariffs, but the change of government in India will cause a delay. At the May 14 OECD meeting in Paris, WTO Director General Supachai called for more progress on agriculture market access to match the advances in reducing subsidies.

Meanwhile, the FTAA negotiations remain deadlocked. The Trade Negotiating Committee has been unable to agree on modalities for moving ahead at talks in Puebla, Mexico to achieve a "balanced set of rights and obligations." Co-chairs the US and Brazil have not announced a date for a full meeting of the TNC and informal consultations will continue this month to try to reach a meeting of minds. Agriculture is one of the major areas of disagreement. The US insists that agriculture must be dealt with in the WTO. For its

part, Brazil does not want stronger intellectual property rights or investment rules. At the end of April, a Brazilian official said the FTAA should concentrate on market access only. The year-end deadline for finalizing the FTAA negotiations seems more distant than ever.

### *Observations*

Brazil has done US taxpayers a favor by calling attention to the excessive and indefensible subsidies given to a handful of cotton growers. There are 25,000 cotton farmers in the US and the top 10% (2,500 farmers) received 78% of the \$1.3 billion in subsidies from American taxpayers in 2002. The idea that you can heavily subsidize cotton production while not affecting world price and output has no basis in economic theory. The reasons for the subsidies are political and therefore in this highly political year no change is likely. Progress is possible after the elections, and in fact the US has tabled a proposal in the WTO to eliminate subsidies and tariffs over a five-year period. The proposal calls for ending monopolies and special privileges of state trading companies, prohibiting export taxes, establishing specific rules to govern export credits, and expanding WTO reporting to increase transparency of food aid activities.

Brazil maintains high tariffs in the industrial sector. In agriculture, Brazil enjoys competitive advantages from low wages and plentiful land, yet its average agricultural tariff level for all agriculture exceeds 30%, compared to the US average of less than 12%. Brazil does not have the fiscal resources to subsidize its agriculture or its industry so it uses tariffs and passes the cost on to consumers through higher prices and lower quality products. The lack of subsidies has nothing to do with abhorrence of market interference.

The WTO agriculture negotiations could gain steam this summer as a result of a few positive developments. Two of these have already been mentioned: the G20 commitment to make a proposal on agriculture market access and the EU's stated willingness to agree to eliminate export subsidies. In addition, USTR Zoellick gave an upbeat assessment at the May 14 closing of the OECD meeting, insisting that the new US Farm Bill that will take effect in two years will reflect whatever disciplines are negotiated in the WTO on domestic subsidies and export credits. He was optimistic that progress will be made at the meeting of experts in Geneva in June.