Brazil's WTO Cotton Case: Negotiation Through Litigation

What we want is progress . . . I am not worried about American interests. I am concerned with international trade interests, with Brazilian farmers, with African farmers, with developing country farmers. I have support inside the government, in the U.S. newspapers, in talking with Americans. . . . For me, I win both ways. I win if I win, and if I lose, I still win because I'm helping to change. I add another brick. There's a lot of support for the [cotton] case. It's complete distortion.

— Pedro de Camargo Neto, former Brazilian Deputy Minister of Agriculture

The Changemaker

Pedro de Camargo was excited. Years of persistent efforts to try to advance the interests of Brazilian farmers seemed to be coming to fruition. On June 18, 2004, a World Trade Organization (WTO) dispute panel sided in Brazil’s favor on most of its claims against United States cotton subsidies (Exhibit 1). The West African nations of Benin and Chad, both heavily dependent on cotton for export revenue, joined Brazil’s case as third-party signatories and also stood the benefit from the ruling. Two months later, a second panel issued a preliminary ruling declaring European Union (EU) sugar export subsidies illegal in a case brought by Brazil, Thailand, and Australia (Exhibit 2).

Pedro couldn't help but feel a sense of accomplishment. As the deputy minister of agriculture in Brazil from 2000–2002, he persuaded Brazilian government officials to launch the two dispute cases and even flew to the WTO headquarters in Geneva in September of 2002 to file them himself. By leading the charge against the United States and EU on cotton and sugar, Mr. de Camargo positioned Brazil as an undisputed leader at the WTO and earned the respect and support of his peers in all corners of the globe.

Mr. Camargo was once again returning home to Brazil from Geneva, where trade negotiators worked day and night against their July 31, 2004 deadline to come up with a framework text for moving the negotiations forward. After the acrimonious collapse of the September 2003 trade talks in Cancun, Mexico, some speculated that yet another failure could deal a fatal blow to the current round of negotiations, called the Doha Round. But newspapers around the world praised the ambitious July framework; "Minor Miracle in Geneva" ran one Financial Times headline (Exhibit 3).
News reports widely credited the dispute challenges brought by Brazil for breathing new life into the negotiations. Faced with the prospect of having to overhaul their farm programs even without a new trade agreement, the United States agreed to substantial reductions in domestic support and the EU offered to phase out export subsidies—concessions that were not seriously debated in Cancun. Pedro’s reaction to the July framework was more subdued, however. Though he felt the elimination of export subsidies was a real victory, he worried that trade negotiators were able to reach a compromise only because they had postponed the hard decisions for a later date.1

On the plane ride back to Brazil, Mr. de Camargo reflected on this historic moment for the WTO. The cotton dispute was the first time a developing country successfully challenged a developed country’s agricultural subsidies. While Pedro was impatient for reform, he recognized that nearly every country faced domestic constraints. Around the world, agriculture enjoyed significant historical and economic power, endowing farm lobbies with tremendous political influence. And as Pedro knew from his years of experience in Brazil, the farm vote was frequently critical to providing stability. Rightly so, governments were concerned with food security, with providing a safety net for their agricultural producers, and with environmental and natural resource management. Pedro was keenly aware that all of these factors made the road towards liberalization of world agricultural trade loaded with political landmines.

Pedro hoped the preliminary success of the two dispute cases would help break down longstanding artificial trade barriers in agricultural goods, but he knew a long road lay ahead. Both the United States and the EU had promised to appeal the panels’ decisions. Even though the United States and the EU agreed to reforms in principle, the language in the July framework text was still quite vague. Pedro strongly believed the United States and the EU were not living up to past agreements, and like many of his colleagues from developing countries, he was highly mistrustful that developed countries once again would attempt to avoid real reforms by creating loopholes for themselves in the current agreement (Exhibit 4).

But now Brazil was nearly assured two major legal victories, even on appeal. Would the cotton and sugar rulings give developing countries the leverage they needed to secure substantial reforms in world agricultural trade? Was this the time and opportunity, Mr. de Camargo asked himself, to make a break with the past and create something positive for the future?

Pedro de Camargo’s Background

Pedro could not have predicted his own role in this historic turn of events. Though he was born in 1949 into a family of cattle ranchers and sugar farmers, he chose a different route from an early age. Pedro got a master’s degree at MIT and then pursued a Ph.D. in engineering from the University of Sao Paolo. He had worked as an engineer for nearly two decades when, in 1990, he decided to switch careers. He ran for president of the Brazilian Rural Society (BRS), the oldest and most prestigious agricultural lobby group, whose membership consisted of farmers and ranchers from Sao Paolo state and neighboring states.

1 Countries still stood far apart on the market access pillar, for example, which the United States had designated as a top priority for reaching an agreement. The EU, India, Japan, and Korea in particular were reluctant to agree to tariff reductions. On the domestic support pillar, some trade negotiators asserted that it remained unclear from the July framework whether the United States would actually be forced to reduce the amount of subsidies paid to domestic producers.
Pedro won, and the beginning of his tenure as president of BRS coincided with the opening of the Brazilian economy. In a very short period, the Brazilian government lowered tariffs and eliminated import controls and price interventions. Imports grew, and Pedro lobbied the Brazilian government to levy countervailing duties on subsidized imported products, like U.S. wheat and cotton and EU beef and dairy products. “This whole issue of trade caught my attention,” said Pedro de Camargo. “We could see that it was very unequal terms, so we started advocating for stronger positions in trade negotiations.”

In the early 1990s, while Pedro was president of BRS, the Uruguay Round of trade negotiations was under way at the GATT, the precursor to the WTO. He attended many of the meetings, lobbying Brazilian trade negotiators to take a more aggressive stance. “When we went to Singapore in 1997,” he said, “we pressed the minister to negotiate. We wanted more!”

The Uruguay Round Agreement on Agriculture (AoA) was the first multilateral agreement that applied international trade rules to the agricultural sector (Exhibit 5). The agreement forced WTO members to implement a series of reforms over a ten-year period, beginning in 1995, and set 2000 as the deadline for launching a second round of negotiations to continue the policy reforms. The goal of the AoA was to move the agricultural sector towards more market-oriented policies. It called for tariff reductions and applied spending caps on the types of domestic support policies that distorted market signals.

For example, the amount of “trade-distorting” subsidies countries could give their agricultural producers, referred to as “amber-box” support or AMS, was capped and reduced over time. Trade-distorting subsidies included payments “coupled” to prices, production levels, or to a specific commodity, because they stimulated overproduction and crowded out imports or led to low-priced exports. “Decoupled” subsidies, such as direct payments, were not tied to prices or to production levels, meaning they had much less distorting effects. Also called “green-box,” these payments were not subject to spending caps under the AoA.

Many hailed the agreement as a victory and trumpeted the new disciplines imposed on agricultural producers, but Pedro believed the AoA did far too little to reduce the distortions in the world agricultural system that worked to the disadvantage of developing nations. “The Uruguay Round was such a frustration for developing countries,” he said. “But I had this perception that it meant, from now on, no back steps. From now on, the next round will give me progress.” He was particularly disappointed that Brazil had not assumed more of a leadership role in the negotiations. “It’s our obligation to face the United States and Europe, because we have the size to do it,” he said. “We are the commercial leaders. We have to be the political leaders as well.”

So when the Brazilian Minister of Agriculture asked Pedro to become his deputy minister in 2000, the year new agricultural negotiations were launched, Pedro sensed an opportunity. His first day on the job, Pedro convinced the Minister of Agriculture to let him coordinate trade policy for the whole ministry. While his colleagues in the Foreign Relations Ministry continued to negotiate multilateral and regional trade agreements, he ultimately convinced the Ministry of Agriculture to pursue a different strategy: litigation. “I had this idea to do dispute cases,” said Pedro de Camargo.

I learned from the countervailing duty cases I had lobbied for as president of BRS that with the limited resources we have, cases are how you can provoke changes. . . . Cases are a communication tool. They are the best strategy to communicate what the U.S. Farm Bill does to

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2 Under the Uruguay Round agreement, the annual amount that the United States could spend on trade-distorting subsidies (called its AMS commitment, for Aggregate Measure of Support) was $19.1 billion.
international trade. They are an important instrument to make [the United States and the European Union] sit down at the table and really negotiate seriously. . . . They are also a way to construct the Agriculture Ministry’s relationship with the Foreign Relations Ministry, because our relationship with them is difficult.

His second day as Deputy Minister, Pedro called the agricultural economists at the ministry who specialized in WTO commitments. He told them to start researching commodity markets of interest to Brazil, such as soy, sugar, and cotton, and “find out where the Americans are going wrong.” Pedro was determined to bring a case against U.S. soybean producers, something he had already spent several months working on before he left BRS to join the government. He commissioned a study on U.S. soybean programs, which “came back with what started this whole cotton case, because it came back with the Peace Clause,” he said.

Commonly referred to as the Peace Clause, Article 13 of the Uruguay Round Agreement on Agriculture effectively prohibited WTO members from challenging other members’ agricultural subsidies at the Dispute Settlement Understanding (DSU), the court system of the WTO. The Peace Clause, which was included in the AoA at the insistence of the United States and the EU, protected countries from action as long as their aggregate subsidy levels remained under their AMS commitments. If countries exceeded their allowable levels, they were no longer afforded protection from dispute cases under the Peace Clause.

Article 13 also contained a second, little-known passage stating that no specific commodity could be subsidized at a rate higher than what producers received during the 1992 marketing year. In other words, if producers of any given commodity received subsidies in excess of the amount they received in 1992, the Peace Clause did not apply. Pedro found his back step. “The U.S. was not subsidizing soybeans during the Uruguay Round, and [in 2000] they were spending $2 billion,” he said. “So we had a case.”

Victory would not come easy, however. Brazil had to mount a compelling legal case to convince a WTO dispute panel that the United States had violated its commitments under the Uruguay Round agreement.

Brazil Mounts a Case

From Soy to Cotton

In late 2001, Pedro de Camargo hired the Chicago-based law firm Sidley Austin Brown & Woods to represent Brazil, led in the Geneva office by Scott Andersen. In early 2002, Scott contacted Dan Sumner, an agricultural economist and professor at UC Davis, and asked him to testify as an expert witness for Brazil. An expert on United States Department of Agriculture (USDA) support programs and econometric models, Dan Sumner was often called upon to offer expert testimony before the U.S. International Trade Commission, a quasi-judicial federal agency that provides trade expertise to Congress and the executive branch. “We were talking about soybeans initially,” Dan Sumner

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3 Cotton was grown on two million acres in Brazil, just a small fraction of the 18 million acres devoted to soybeans. But cotton and soy are good crops to rotate with each other, and Brazil intended to expand cotton production as a strategy to enhance the efficiency and competitiveness of its growing textile industry.
Dan Sumner provided Brazil’s legal team with an analysis of U.S. farm legislation. The United States had been moving towards more market-oriented agricultural support policies for over a decade, but in 1997–1998, the bottom fell out of commodity markets due to the East Asian financial crisis. The unexpected price decline in global commodity markets stressed agricultural producers in every country, forcing many governments to enact emergency relief programs. The United States Congress was no exception. Reeling from depressed world demand and a severe drought in several U.S. states, Congress passed supplemental legislation that authorized additional emergency payments to farmers of $30 billion over a four-year period.

Critics charged the United States with reverting back to the old system of price supports. Called the marketing loss assistance program, the emergency payments acted like a price floor, because they automatically kicked in when the world price fell below a designated target price. The payments became permanent in the 2002 Farm Bill, renamed countercyclical payments (Exhibit 6).

The new legislation frustrated negotiators and agricultural producers abroad, and undermined the United States’ professed commitment to serious reforms in the Doha Round. “The 2002 Farm Bill completely undercut the credibility of the United States in WTO agricultural negotiations,” said Dr. Bob Thompson, a former USDA economist under the Reagan Administration and the current President of the International Food and Agricultural Trade Policy Council. “We just looked two-faced: do as I say, not as I do.” Joe Glauber, Deputy Chief Economist at the USDA and head economist in the cotton case, agreed that was a common perception. “Brazil was the one that ultimately brought the challenge, but the criticism was coming from a lot of places,” he said.

The large emergency payments and marketing loan payments caused U.S. soybean programs to vastly exceed their negligible 1992 levels, but as Pedro and his team assembled their case, domestic politics took over and market conditions changed. Officials in the Foreign Relations Ministry requested additional soybean studies, which dragged on for months. “The Foreign Relations Ministry wouldn’t approve,” says Pedro de Camargo. “They fought me. I think they were afraid we would lose.” In the interim, soybean prices started to rise, no longer making U.S. soybean farmers eligible for large payments. The soybean case disappeared.

Then an economist in Brazil’s Ministry of Agriculture alerted Pedro to what was happening in the world cotton market. By most accounts, cotton was one of the most distorted commodities in the world, stemming from high levels of government subsidies (Exhibit 7). Between the 1998–1999 and 2001–2002 marketing years, global direct assistance to cotton producers ranged from $3.8 billion to $5.8 billion, divided between eight countries: the United States, China, Greece, Spain, Turkey, Brazil, Mexico, and Egypt.4

During that period, cotton prices were in precipitous decline. Between December 2000 and May 2002, the world price of cotton declined by 40%, shrinking the value of the global cotton market from $35 billion to $20 billion in just eighteen months. The price of cotton bottomed out at 29 cents a pound

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4 According to the International Cotton Advisory Committee, U.S. cotton producers received a record of $3 billion in subsidies in 2001–2002, accounting for more than 52% of global government assistance. That figure is somewhat misleading, however, because it did not include an additional $900 million U.S. cotton producers received in direct payments and crop insurance. Also in 2001–2002, China provided its cotton farmers with $1.2 billion (21% of world total), the EU paid producers in Greece and Spain a total of $980 million (17%), and India gave its producers $500 million (9%).
(compared to an all-time high of 74 cents a pound in 1995). Adjusted for inflation, it was the lowest cotton prices had been since the Great Depression.

The reasons for this dramatic price decline were complex, but nearly everyone pointed their finger at the United States. The United States was the second largest producer of cotton behind China, by far the largest exporter, and spent vastly more on cotton subsidies than any other country. The low price environment triggered U.S. price-based support programs, causing U.S. cotton programs to exceed their 1992 levels (Exhibit 7, Table 7B). All told, U.S. cotton producers received payments ranging from $1.9 billion to $3.9 billion during the 1998–2002 marketing years, far exceeding the 1992 level of $1.4 billion. “Nearly $4 billion of subsidies by one country is a lot of money in an industry where the world value of cotton at the time was $20 billion,” says John Baffes, a senior economist at the World Bank. “There’s no way one can claim that does not have an effect on the world market.”

Pedro immediately saw the possibilities. Since many of the subsidy programs used to support U.S. cotton growers were used for other commodities as well, a victory in this case could mean the United States would have to overhaul its domestic farm programs or face sanctions at the WTO. “Cotton was not a routine dispute,” he said. “[It was] there for broader reasons and fought with that idea.” Dr. Bob Thompson agreed the case served to clarify the commitments developed countries agreed to in the Uruguay Round. “The Brazilians are absolutely right,” he said. “The United States and the EU have not been playing fair under what they agreed to in the last round. The two [dispute rulings] are going to be very strong messages about the true effects of U.S. and EU policies.”

Pedro also hoped a legal ruling would also give additional momentum to reformers within the United States and the WTO who wanted to achieve greater reductions in subsidies in the Doha Round of trade negotiations. “I wanted the dispute to influence the round,” he said. “It is a broad case that . . . has very good, positive implications—more transparency and more clarification on what we’re signing, what we’ve already signed, and what we will sign.”

A Lucky Break

In July of 2002, Brazil’s cotton challenge received a stroke of luck. Economists at the World Bank and the International Cotton Advisory Committee (ICAC), an international commodity organization with 42-member governments, were concerned about the precipitous decline in cotton prices and felt that distortions in the market were not widely understood. So in July 2002, World Bank economist John Baffes and his colleagues at ICAC hosted a joint conference.

Pedro de Camargo was in attendance. Other participants included representatives of the U.S. National Cotton Council, African and Brazilian ambassadors, Oxfam’s head economist, and academics. “In one room we had all the guys, and they all told their stories,” said John Baffes. Turkey, Brazil, Mexico, Egypt and India had to give offsetting support totaling $600 million to keep their cotton sectors afloat. The highly indebted West African governments of Benin, Burkina Faso, Chad and Mali also were forced to divert public funds from elsewhere and give producers $50 million to prevent their domestic industries from collapsing.5 “All the West Africans were talking about cotton,” said Pedro de Camargo. “And I thought, ‘This can’t happen.’ Of course it made our case much stronger.”

Also at the conference, ICAC economists presented the findings of their econometric simulation model, which showed that U.S. subsidies had caused significant price suppression. In the absence of

U.S. subsidies, the authors claimed, U.S. production would have declined by 900,000 tons in 1999–2000, 700,000 tons in 2000–2001, and 1.4 million tons in 2001–2002, raising the world cotton price for those years by 6 cents, 12 cents, and 22 cents, respectively. Shortly after the ICAC conference, Scott Andersen called Dan Sumner and asked him create a modeling framework for cotton.

**Brazil’s Claims Against the United States**

Over the next few months, Brazil’s cotton case quickly took shape. Though Brazil’s arguments are highly complex and technical, they can essentially be broken up into legal and economic claims. In legal terms, Brazil claimed that during the marketing years 1999–2002, U.S. cotton subsidies exceeded their 1992 levels, a violation of Article 13 of the Agreement on Agriculture (the Peace Clause). Brazil also argued that two additional support programs, the export credit guarantee program and Step 2 payments, constituted export subsidies and as such were prohibited under the Agreement on Agriculture.

In economic terms, Brazil argued the United States’ cotton subsidies caused “serious prejudice” to Brazilian cotton producers, a violation of the Agreement on Subsidies and Countervailing Measures. Their basis for claiming serious prejudice was twofold. First, Brazil claimed U.S. cotton subsidies caused price suppression of world cotton prices. Using hundreds of pages of USDA data and building on an econometric model developed by the Food and Agricultural Policy Research Institute (FAPRI), Dan Sumner’s econometric analysis was commissioned to bolster this argument. If U.S. cotton subsidies were eliminated, the model predicted, U.S. cotton production and cotton exports would have declined by 29% and 39%, respectively, causing world prices to increase by 6.5 cents/pound (or 12% of world price). Extrapolating from that data, Brazil claimed depressed cotton prices cost its producers $478 million in lost revenues from 1999-2002.

Brazil’s second argument revolved around the United States’ rising share of world exports. Brazil claimed U.S. cotton subsidies allowed U.S. producers to capture world market share, which caused a corresponding loss in market share for Brazilian producers. While most of the world responded to declining world cotton prices by scaling back production, U.S. cotton producers actually increased acreage (Exhibit 6, Figure 6B), with more and more of that acreage planted for export. From 1998 to 2002, the United States went from exporting one-third of its cotton to two-thirds, implying that its share in the world export market jumped from 24% to 48% within a span of five years (Exhibit 6, Figure 6C). One of the reasons noted for the increase in the export market by the United States may be due to the decline of the domestic U.S. textile industry and the moving of mills overseas as noted by Joe Glauber in Exhibit 8. If the United States was justified in claiming its cotton programs did not shelter American producers from market signals, Brazil argued, then why in a time of declining prices were U.S. producers planting more cotton, not less?

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8 FAPRI was established by Congress in 1984 and was jointly run by two universities—Iowa State University and the University of Missouri at Columbia.
9 Pedro de Camargo, the WTO Cotton Dispute.
A Final Hurdle

Brazil’s Council of Foreign Trade, or CAMEX, consisted of four of Brazil’s most powerful ministers (the Ministers of Finance, Industry & Trade, Agriculture, and Foreign Relations) and the Chief of Staff of the President. Throughout 2002, Pedro had been briefing CAMEX about the progress he was making in preparing the cotton and sugar disputes. But he needed the ministers’ formal approval to file the cases at the WTO.

Foreign Relations officials, however, were reluctant to proceed. “The Foreign Relations Minister said we needed more studies,” recalled Pedro. “The [diplomats] below him were not in favor... It’s such a pioneering case that it’s natural they would get more nervous and more careful.” Officials kept pressing for more time, citing concerns about the political implications of filing a challenge against the United States while the Doha agricultural negotiations were ongoing. “As bureaucrats, their timetables are different,” said Pedro. “I knew I was leaving government December 31st, so for me it was now or never.”

Pedro also wanted to see if the West Africans would join Brazil’s case as co-complainants, but he could not approach them directly. As a representative of the Agricultural Ministry, he remarked, “I could not contact the African countries. That’s Foreign Relations.” And Foreign Relations was vehemently opposed to getting the Africans involved. “I think [they] felt that the Americans would get really irritated if Brazil started pitting Africa against the United States,” said Pedro.

Instead, he struck up a friendship with the Beninese diplomat at the WTO, Samuel Ameliou, with whom Pedro frequently crossed paths at agricultural committee meetings in Geneva, and sent him some documentation on the cotton case. While in Geneva, Pedro also met with Celine Cherveriat, Head of Advocacy for Oxfam, to talk about the world cotton market and the implications for West African smallholder farmers. He previously had worked with Celine on Oxfam’s Fair Trade campaign and was impressed with the organization’s work. “I could not reach the Africans by myself, so I went through Oxfam,” he said.

After three more months of internal meetings with CAMEX, Pedro once again went before the ministers at the September 19, 2002 meeting. He requested their approval to launch the cotton and sugar disputes. The Ministers were still apprehensive. But the Finance Minister urged them not to put off for the next administration what they could do themselves. “That was a crucial moment,” recalled Pedro de Camargo. “The [finance minister] saved it.”

Pedro flew to Geneva and filed the sugar and cotton disputes at the WTO on September 27, 2002.

The West African Cotton Sectoral Initiative

Though Brazil has an economic interest in cotton, the crop is by far more important to several poor countries in West Africa, where it is widely considered a success story. Initiated by the French state-owned Compagnie Francaise pour le Developpement des Fibres Textiles (CFDT) before independence, production in the region grew tenfold from less than 100,000 tons in the 1960s to nearly one million tons by the late 1990s. By 2000, the sector employed nearly ten million people throughout

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10 After independence, the West African countries set up their own national cotton companies, but CFDT retained around one-third of shares in the companies. In 1996, the World Bank pushed for reforms to enhance the competitiveness of the Francophone cotton sector, but both the French and the West Africans resisted the reforms. Recently, however, Benin, Cote D’lvoire, and Togo made progress towards liberalization, including opening the sector to competition from private gInners.
Francophone Africa. The region accounted for 5% of world production and was the third-largest exporter after the United States and Uzbekistan, with 15% of global exports. In the 1998–1999 marketing year, cotton accounted for 7.1%, 5.1%, 6.7%, and 4.7% of the respective GDPs of Benin, Burkina Faso, Mali, and Chad, and between 30% and 43% of their merchandise export earnings.

Though the Francophone cotton sector was considered a success, there were considerable market inefficiencies. First, the national cotton companies had legal monopolies on all ginning and marketing activities, as well as the provision of inputs to farmers, such as seeds and pesticides. This virtual lack of competition encouraged operating inefficiencies and rent-seeking behavior. Second, farmers typically received only 30%–40% of the world price, with the rest going to governments in the form of various taxes. Third, the close economic ties between Francophone Africa and the European Union effectively prohibited the African nations from cultivating genetically modified cotton (called Bt cotton), even though multiple studies concluded that developing countries stood to benefit the most from its adoption.

During the price decline that took place from 1998 to 2002, the four West African countries of Benin, Burkina Faso, Mali, and Chad estimated that depressed cotton prices cost them a combined average of $250 million a year in lost revenues. The sudden loss of export revenue triggered a balance-of-payments crisis for the impoverished nations, and the resulting budget deficits put their governments behind IMF targets for repaying their debt. The African governments clearly needed to take action. But what was the best course of action to take?

After Brazil filed the WTO case, there was still a window of opportunity for the West Africans to sign on as co-complainants, but they were reluctant. WTO disputes take two to five years to resolve; what kind of relief could they expect in the meantime? What would be the political fallout of signing onto a case against the biggest member of the WTO? Most importantly, if they won the case, and the United States refused to implement the decision, what would be their recourse? Celine Cherveriat, the Head of Advocacy for Oxfam, was heavily involved in consultations with the West Africans. Explaining their dilemma, she said, “A small country like Benin or Burkina Faso cannot really retaliate against the United States, because it would be relatively counterproductive for them to slap tariffs on U.S. goods and it would be absolutely meaningless for the United States. So the [West Africans] thought the DSU instrument was not terribly adapted to what they wanted to achieve.”

Finally, after weeks of consultations with NGOs such as Oxfam, only Benin and Chad decided to join Brazil’s case—not as co-complainants, but as third parties. Third-party signatories could make presentations and submit testimony in a side venue, but they could not participate in the main panel hearings (although they were allowed to attend). Pedro was disappointed the West Africans did not

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11 A percentage of the tax revenue paid for rural extension services like road maintenance, but the taxes were sometimes used to subsidize other sectors of the economy.

12 Developing country farmers would benefit in several ways, although they would be paying a premium for the genetically modified seed. Bt cotton requires fewer sprayings, so farmers would save on pesticide and fertilizer costs. This would also have positive health effects because the inappropriate handling of pesticides is a major source of health problems and accidental death. Second, adopting Bt cotton would lead to yield increases as compared to conventional cotton, helping farmers boost their profit margins.

13 Benin, Burkina Faso, and Chad incurred economic losses greater than what they received in debt relief under the initiative for Heavily Indebted Poor Countries (HIPC). In the case of Mali, $43 million in revenue losses more than offset the $37 million they received in foreign aid. Oxfam 2002.

14 Along with the Francophone nations of Benin and Chad, third-party signatories on the Brazilian cotton case included Argentina, Australia, Canada, China, India, New Zealand, Pakistan, Paraguay, and Venezuela.
join the case as co-complainants, but then again, he reasoned, he could not get other cotton-producing countries to sign on either. “I tried Argentina, I tried Australia, I tried South Africa,” he said, adding that none of them “wanted to challenge the United States.” He continued: “I saw all of the problems we had within Brazil to find the courage to file the case. Argentina, who was in a mess with the IMF, couldn’t do it. Australia, the leader of the Cairns group, couldn’t do it because they were negotiating a free trade agreement with the United States. Why would Benin?”

**An Unconventional Initiative**

NGOs like Oxfam and IDEAS Centre, a Swiss organization that provided consulting services to developing countries on trade and development issues, continued working with the West Africans on alternative ways to bring forward their demands on cotton. Shortly after the African governments made the decision not to join Brazil’s case, Nicolas Imboden, Executive Director of IDEAS Centre, traveled throughout the Francophone capitals and lobbied agricultural ministers to form a coalition. He ultimately convinced only four West African nations to get on board: Benin, Burkina Faso, Chad, and Mali.15

“There is a wider issue that the poorest members of the WTO don’t know if they will get anything positive from this round,” said Celine Cherveriat, “so they are going with the flow, not clear about how to extract something that is actually meaningful to them.” During the consultations with Oxfam and IDEAS Centre, however, it quickly became clear to the West African coalition that, given the heavy dependence of their economies on cotton, the one thing they should focus their energies on was a concession on U.S. cotton subsidies.

They knew they would have to be creative, and so they made an unprecedented decision: they would lobby the WTO to include a separate initiative on cotton in the Cancun text. “The only way for [the West Africans] to bring an issue [to the WTO] is to do it in an unconventional way, because they are quite powerless countries with a very low profile,” says Celine Cherveriat. In fact, only two of the four nations have permanent missions at the WTO headquarters in Geneva. “Before this all happened, Benin, Burkina, and Mali—nobody even knew the names of their ambassadors,” she continued. “Nobody cared about those countries at all.”

NGOs remained heavily involved with the West African efforts. Oxfam commissioned studies about the impact of low prices on West African economies and helped villagers’ cooperatives bring their stories to journalists in Europe and the United States. Oxfam also used its media contacts to facilitate press conferences and the placement of op-eds by West African officials. “We knew that 90% of the battle was going to be in terms of the media, and whether we could make this a moral case and win it in the public eye,” says Celine Cherveriat. “From the beginning, Oxfam’s strategy [was] to bring it down from something legalistic that nobody would understand to the most important story: the impact on farmers on the ground.”

*The New York Times*, *The Washington Post*, *The Wall Street Journal*, and others picked up the story and ran articles and op-ed pieces blasting the reach of “King Cotton” and its effects on poor African farmers. Many in the media even framed the cotton case as a “litmus test” of whether the WTO and the international trade system could work for the poor. Meanwhile, IDEAS Centre and private donors raised funds and contributed expertise to coordinate the activities of the four Francophone countries,

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15 Senegal, Togo, and Cote d’Ivoire also produced cotton, but they decided not to join the West African coalition, possibly because cotton was of less significance to their economies.
assist the African representatives prepare for presentations, defray travel costs for the ministers, and create an additional post in the Benin mission at the WTO.

Four Landmarks in a Landmark Case

Four major milestones marked the West Africans’ campaign in the run-up to Cancun. First, on April 30, 2003, Benin, Burkina Faso, Chad, and Mali submitted a “Sectoral Initiative in Favor of Cotton” to the WTO, which demanded that developed countries:

1. phase out all domestic support and export subsidies for cotton within three years, and
2. put in place a transitional financial mechanism to compensate cotton-exporting LDCs $250 million a year—the amount they claimed they were deprived of in lost revenues—until the subsidies were eliminated.

Second, in the mini-ministerials over the summer, the West Africans secured support for their initiative by the Least-Developed Country group (LDC) and the African, Caribbean, and Pacific group (ACP), critical to demonstrating the solidarity of developing countries. Then in July 2003, the President of Burkina Faso, Blaise Campoare, became the first ever head of state to address the WTO general assembly. “That really launched the political fight to get some kind of language in the Cancun text,” said Celine Cherveriat. Speaking on behalf of the four West African countries in the coalition, President Campoare said:16

From this platform, I am launching an appeal, in the name of several millions of women and men who live in least developed countries and for whom cotton is the main means of subsistence . . . I ask the WTO and its member States to prevent these populations, who are victims of the negative impact of subsidies, [from being] excluded from world trade. The ongoing Doha Round negotiations on agriculture must imperatively address distortions in cotton trade. . . . Our countries are not asking for charity, neither are we requesting preferential treatment or additional aid. We solely demand that, in conformity with WTO basic principles, the free market rule be applied.

Finally, less than two months before the Cancun ministerial, the WTO Secretariat put cotton on the official agenda due to tremendous pressure from WTO members demanding something be done. In consultation with the Chairman of the General Council, the Secretary scheduled the Sectoral Initiative for the first day of negotiations. In an extremely rare move, the WTO Director-General, Supachai Panitchpakdi, offered to chair the session, imploring developed countries to “take the West African proposal seriously.”

The Cancun Debacle

On September 10, 2003, thousands of trade negotiators, politicians, lawyers, NGOs and activists descended on Cancun, Mexico. The Cancun ministerial marked the first formal negotiations since the Doha Round was launched in Doha, Qatar, shortly after the September 11, 2001 terrorist attacks. Dubbed the Doha Development Agenda, the mandate of the Doha Round was to focus on the needs of developing countries, many of which have large rural populations and viewed a good agriculture agreement as the key to achieving meaningful gains in the round.

Yet developing countries pointed to the 2002 U.S. Farm Bill and the joint U.S.-EU draft agriculture text issued just weeks before the ministerial as evidence that developed countries were not serious about reform. The U.S.-EU draft text proposed large cuts in developing countries’ agricultural tariffs, but it did not offer substantial reductions in their domestic support levels or export subsidies in return. (Nor did it even mention the cotton issue.)

Developing countries were indignant that they were being asked to open their markets and expose their farmers to what they commonly referred to as "competition from the U.S. and EU treasuries." The U.S.-EU draft agriculture text triggered the creation of the G-20, a coalition of developing countries led by Brazil, India, China, and South Africa. "Brazil’s leadership in the dispute cases against the United States and the EU was fundamental to creating the G-20," said Pedro de Camargo. The trade ministers from the 20 members of the impromptu alliance met for the first time in Cancun, one day before the start of negotiations. Over the course of next few days, the G-20 proved to be a formidable force, resisting repeated attempts from the United States and EU to splinter the coalition and consent to a watered-down agricultural agreement.

Outside the Cancun conference hall, protesters held puppets of George Bush throwing cotton. Inside, negotiations broke down. Though the Cancun talks officially collapsed in September 2003 over contentious issues like competition and investment policy, called the “Singapore issues,” many who were present say the stalemate in agriculture played a more significant role. "There’s a standoff," said Bob Thompson, referring to the breakdown in agricultural negotiations. "U.S. farm groups say they’ve got to have access to developing country markets if they’re going to reduce their subsidies, and the developing countries say, you’ve got to go first with reducing your subsidies because they artificially depress the international prices. That’s the most important tension."

Some even speculated that the United States’ refusal to deal meaningfully with the cotton issue contributed significantly to the acrimony of the talks. At a minimum, U.S. negotiators underestimated the resolve of the West Africans and the widespread sympathy they enjoyed among developed and developing countries alike. The United States demanded that cotton be treated within the context of overall negotiations, not as a stand-alone issue, while the West Africans categorically rejected that idea. "I think the U.S. went through some good faith negotiations—maybe three or four hours a day," said Joe Glauber. "That said, were we talking past one another? Yes, I think so."

Others who were present claimed the Sectoral Initiative was probably too unconventional to gain any real traction, since it was not part of the normal exchange of concessions that characterize WTO negotiations. The biggest stumbling block was the issue of a compensation mechanism. "Compensation couldn’t take place the way it was envisioned or designed," said John Baffes. "If you think about it, how are you going to compensate ten million West African farmers? Is the IRS or the U.S. Congress going to write them $100 or $200 checks? It’s just not going to happen."

Any progress or goodwill that had been made during the first three days of negotiations evaporated when the new framework text was distributed. Not mentioning the West African cotton proposal by name, it essentially reiterated the United States’ demands that (1) elimination of cotton subsidies must be part of a multilateral effort, (2) broader reforms were necessary to address the distortions in the textile and synthetics sectors, and (3) multilateral donor institutions should assist the African countries with technical and development assistance.

Exactly how that third demand would be worded was still unresolved thirty minutes before the U.S. delegation was expected back at the conference center. "We were in our hotel going back and forth, negotiating changes in the language," said Joe Glauber. "The phrase we worked on was
innocuous. It said something like, ‘the multilaterals should help African countries modernize their cotton industries.’”

But when the draft was circulated on September 13, it included language Joe Glauber had not seen—a line instructing the WTO Director-General to work with donor institutions to “effectively direct existing programs and resources toward diversification of the economies where cotton accounts for the major share of their GDP.”17 When Joe Glauber first saw a copy of the published draft, “I was taken aback,” he remembered. “It just seemed like a slap in the face after what had been four days of good faith negotiations.” The West Africans—and all of their supporters—were outraged at the U.S.’s intransigence.

In the wake of Cancun, progress on the cotton issue was considered a sine qua non to restarting Doha negotiations. “Everybody realized that if you want to move on the Doha Round, you have to deal with this case,” says John Baffes. “Even the West African countries realized, since we’re not going to go ahead with compensation in the way we designed or thought, we’ve got to do something else.”

To that end, the WTO and the World Bank co-hosted a conference in Benin in March, 2004, to determine how the bilateral and multilateral lending institutions could best provide technical and financial assistance to the West African cotton sector. “Post-Cancun, there has been a greater realization of the importance of the cotton sector to the growth and poverty reduction efforts of these African countries,” WTO Director General Supachai Panitchpakdi said in his keynote address at the conference. “This is an African priority that deserves our support.”18

Ripple Effects: The WTO Dispute Panel Ruling

On April 26, 2004, the WTO dispute panel issued a confidential preliminary ruling declaring the majority of U.S. cotton programs inconsistent with the commitments the United States agreed to during the Uruguay Round. Although only the parties involved in the dispute saw the actual report, the reaction in the press and in Congress was swift. Referring to the ruling at a press conference the following day, White House Press Secretary Scott McClellan said, “We will be defending U.S. agricultural interests in every forum we need to, and have no intention of unilaterally taking steps to disarm.” U.S. Trade Representative Robert Zoellick testified before the House Agriculture Committee two days later, saying, “You can be one 100% sure we will appeal this ruling. . . . This is a marathon, not a sprint.”

In sharp contrast, supporters of agricultural reform, academics, NGOs, and editorial pages around the world celebrated the decision—as did Brazilian officials. “This is a precedent; this is a war that must continue!” proclaimed Roberto Azevedo, lead counsel for Brazil and a top official in Brazil’s

17 Italics added. The full paragraph reads, “We recognize the importance of cotton for the development of a number of developing countries and understand the need for urgent action to address trade distortions in these markets. Accordingly, we instruct the Chairman of the Trade Negotiations Committee to consult with the Chairpersons of the Negotiating Groups on Agriculture, Non-Agricultural Market Access and Rules to address the impact of the distortions that exist in the trade of cotton, man-made fibers, textiles and clothing to ensure comprehensive consideration of the entirety of the sector. The Director-General is instructed to consult with the relevant international organizations including the Bretton Woods Institutions, the Food and Agriculture Organization, and the International Trade Centre to effectively direct existing programs and resources toward diversification of the economies where cotton accounts for the major share of their GDP” (Oxfam, 2004, p. 7).

Foreign Ministry. Pedro de Camargo added, “We developing countries have shown that we’re prepared to do this and expose them. The panel has given us a position that’s ours. It’s not that we’re getting it free—we paid already in the Uruguay Round. We’re here to collect.”

The panel issued its final ruling on June 18, 2004, which was nearly identical to the preliminary ruling (Exhibit 1). Most significantly, the panel ruled in Brazil’s favor that: (1) U.S. cotton programs were not afforded protection under the Peace Clause because subsidies between 1999–2002 exceeded 1992 levels; (2) price-based support programs such as marketing loan payments and marketing loss assistance payments did cause price suppression; (3) direct payments did not qualify as green-box because of the prohibition on fruits and vegetables; and (4) the export credit program and Step 2 program contained prohibited export subsidies.

**Implications of the Panel Ruling**

**U.S. Farm Programs**

One of the most far reaching rulings, as far as U.S. agriculture was concerned, was the panel’s finding that direct payments did not qualify as green box because of the prohibition on planting fruits and vegetables. “That is an extremely political issue, because if the appellate body confirms that, it means the whole Farm Bill is wrong,” said Pedro de Camargo. Joe Glauber concurred. “The significance of this is substantial,” he said. If the United States had been required to notify the $6 billion in annual direct payments as amber box instead of green box, the United States would have been over its AMS commitments for 1999, 2000, 2001, and 2002 (Exhibit 9).

“This may be the first WTO-driven decision that Congress has to make about a farm program, and it won’t be an easy one,” said Joe Glauber. “Congress is indignant over the idea that something we’ve been reporting as green . . . has now been determined by the WTO to not be green.” Though many believed the prohibition on fruits and vegetables would be easy to fix, it “isn’t just there by chance,” said Joe Glauber:

> There was heavy lobbying in the 1996 Farm Bill by the fruit and vegetable lobby to have that in there—they didn’t want producers to receive payments and quit growing those crops and follow market signals and say, “I’m planting plum trees row to row.” . . . As far as [fruit and vegetable producers] are concerned, this [provision] is the one little thing they got out of the 2002 Farm Bill. So I don’t think it would be easy to overturn.

A second significant aspect of the panel ruling concerned the distinction between price-based and non-price-based forms of support. In its defense, the United States argued that its price-based programs (e.g., the marketing loan program and the countercyclical program) did not distort production, for two reasons: (1) annual outlays depended not on production levels but on what world prices were doing, because they kicked in only when world prices fell below the minimum price; and (2) the countercyclical payments were based on historical production levels, not on how many acres farmers were planting that year. Therefore, the U.S. claimed, the programs had minimal effects on production decisions. As Joe Glauber explained,
In terms of distorting effects, you have to look at these programs on a continuum. Countercyclical is somewhere [in the middle]. The difference with the countercyclical program is you don’t have to produce a crop to receive the payments. They still allow producers to make marketing decisions and planting decisions based on market prices and not on the payment. Producers will get the payment, regardless of whether or not they plant cotton, regardless of whether they harvest 500 pounds of cotton per acre or 600 pounds per acre. From that standpoint, they’re far less distorting (Exhibit 8).

But the panel disagreed, ruling that price-based support programs shielded U.S. farmers from market signals because the countercyclical base rate and the marketing loan rate were set well above market prices at the time. In other words, the programs essentially acted as a price floor, ensuring farmers would receive a good price for their cotton regardless of what the world market was doing—which, the panel reasoned, clearly affected their decisions to plant cotton.

Revamping or abolishing these price-support programs, as the panel recommended, affected far more U.S. commodities than just cotton. The countercyclical and marketing loan programs were designed to encourage farmers to respond to market signals in years of high prices, while at the same time incorporating a mechanism to offset rapid price declines over which farmers had no control. The United States was suddenly faced with the challenge of bringing its programs into compliance with WTO rules while still ensuring farmers had a safety net in years of bad prices.

Yet U.S. officials said they could hardly agree to unilaterally disarm. All nations had rules and regulations that distorted market signals in the agricultural sector. While the United States wanted its agricultural sector to maintain a market orientation, U.S. officials objected to liberalizing U.S. commodity programs while other countries were permitted to keep their distortions. From the standpoint of the United States, the question was: how could countries deal with this problem in a simultaneous way that would resolve the issue to everyone’s satisfaction?

**The Doha Round**

Even though experts disagreed about the precise impact the legal rulings against cotton and sugar would have on the outcome of the Doha Round, it was self-evident that the negotiation dynamics shifted dramatically. For one, Brazil gained the leadership position Pedro de Camargo sought. Brazil emerged in Cancun as a leader in the G-20 coalition of developing countries, and was one of only five countries (along with the United States, EU, India, and China) to be involved in behind-the-scenes consultations during the July 2004 negotiations in Geneva.

More importantly, however, Europe did an about-face in the weeks leading up to the July 2004 talks. The EU offered to eliminate $3 billion in export subsidies in return for the U.S.’s elimination of the export subsidy element in its export credit programs and food aid programs. Many analysts speculated that the impending ruling against EU sugar export subsidies forced European trade negotiators to “see the handwriting on the wall.”

Explaining the risky move to reporters, EU trade commissioner Pascal Lamy admitted the dispute cases provided some impetus. “Of course I think they helped,” he said. “Obviously, the U.S. had to give ground on cotton, and we have to give ground on sugar.” Pedro de Camargo was quick to praise the EU’s action in an interview with the *New York Times*. “I would not have believed it, but in agriculture it is now Europe that is for free trade, not the U.S.,” he said.

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The EU’s concession put the United States on defense. Support from farm states was considered crucial for President Bush’s reelection campaign, putting United States Trade Representative Robert Zoellick under intense pressure to create an agreement U.S. farm groups would endorse. The United States pushed hard for gains in market access and successfully lobbied to change its countercyclical program from amber to blue, despite the cotton panel ruling that countercyclical payments had trade-distorting effects. In the end, the United States agreed to certain constraints on its export credit programs and a 20% reduction in allowable amber box support in exchange for substantial increases in market access.

USTR Zoellick denied the dispute cases had any effect on the outcome of the negotiations. Indeed, cotton was not maintained as a “standalone” issue, as the West Africans wanted. Nevertheless, the July 2004 framework text created a cotton subcommittee to examine the issue and included language that subsidies and other barriers in the cotton trade would be addressed “ambitiously, expeditiously, and specifically” within the context of overall agricultural negotiations.

WTO Director-General Supachai Panitchpakdi hailed the framework agreement as a “historic achievement” and an important step towards a successful conclusion of the Doha Round in 2006. Brazil’s Foreign Minister, Celso Amorim, declared that the framework was “a good deal for trade liberalization and for social justice.” Along with Mr. Amorim, who became a star of the negotiations, EU trade commissioner Pascal Lamy and USTR Robert Zoellick were applauded for forging a consensus.

In 2006, the U.S. Farm Bill would be up for renewal once again, and Congress would have to decide how to incorporate the new WTO rules into domestic farm legislation. But many controversial issues remained for trade negotiators to tackle at the next ministerial, scheduled for December 2005 in Hong Kong, such as the levels of tariff cuts, how to treat special products, and specific timetables for subsidy reductions. Some experts feared that other regulatory policies being negotiated in the round, such as rules on food safety and sanitation, were too burdensome for some developing countries and could replace more conventional barriers to trade like subsidies and tariffs.

Other experts feared that the United States was skirting real reductions in domestic support levels, making it more likely that trade negotiators would encounter the same standoff over market access in Hong Kong. “The U.S. has already announced [insufficient gains in market access] as the excuse not to lower their internal support subsidies,” said Pedro de Camargo, who accused the United States of “box-shifting”—changing the countercyclical program from amber to blue—to offset the 20% reduction in amber-box support offered in the July framework text (Exhibit 10). Indeed, upon his return from the July 2004 negotiations, Allen Johnson, the chief agricultural negotiator of the United States, told reporters, “The United States succeeded in shifting farm subsidies to a new WTO category to avoid actual reductions.”

Pedro de Camargo was concerned that the U.S.’s reluctance to decouple and trim down its support programs diminished the chances for an ambitious Doha agreement:

The U.S. is still rejecting the idea that they have to stop dumping on the world, and that will be necessary to solve at some point in time. The panels are helping a lot, but the U.S. and EU reactions were very different. We got a big step forward in one pillar with the EU, but the step forward the U.S. had to do—I don’t see it. . . . The U.S. exports a lot of products, and they all have high internal support. That’s what we are trying to halt. It may not solve the domestic

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distortions, but we have to get the subsidy component out of the international market at least. And the U.S. is still far from that. I’m not sure we’re going to be able to [resolve this] in Hong Kong.

Conclusion

Even though Pedro was no longer a government official, he was constantly being asked to participate in forums and make presentations to high-level policy makers. As he prepared his remarks for a meeting, he reflected on the big picture implications of the case and the next steps he could take. He may have won the battle, but the war was far from over. What could Pedro do to swiftly move the cotton case towards a fair, mutually acceptable end result?

He jotted down several questions:

Was proceeding with the dispute case the best option? The appeal would take months, and a meaningful implementation could be delayed or sidestepped for years. Having the case drag on indefinitely would not help Brazilian or African farmers. And even if Brazil won on appeal, the history on compliance in dispute cases was mixed. If the United States refused to comply with the ruling, and the WTO authorized Brazil to retaliate, would it really serve anyone’s interests to levy duties on U.S. products entering Brazil? If using the case as a bartering chip in the Doha negotiations was a better option than sticking with the dispute mechanism, how could Brazil leverage the ruling to maximize the chances for reform?

Second, with the July 2004 framework agreement as a direction for negotiations the Doha round would proceed, particularly in 2005 with the new US administration and new European Commissioners leaving to the Hong Kong Ministerial in December 2005. What are the effects of the two cases in the round? The whole issue of what is a Green Box subsidy would have to be addressed. Can a Direct Payment really be considered decoupled support? The Green Box was initially though to accommodate research and extension services subsidies. Can it also include a whole variety of policies, including with environmental labels direct payments to be non-trade distorting? How large a check can you give a producer and still call it decoupled? What is the schedule of reduction in trade distorting support—amber, blue or de minimus—that can be obtained in the new Doha agreement? Can countries export, displacing other countries production, using trade distorting and direct payments subsidies, what ever denomination or box color?

Third, what would the West Africans gain from all of this? In the July 2004 negotiations, the United States promised to speed up subsidy reductions to cotton farmers as a concession to the West African countries. But subsidies are only a portion of the problem, and trade rules should not be used as an excuse for failing to undertake the reforms necessary to improve the domestic competitive environment. In addition, many experts believed that in a completely liberalized scenario, the least developed countries would be worse off because they would lose preferential access to European markets granted under the Lome Accords (Exhibit 11). In the case of cotton, corruption and inefficiencies among the West African parastatals made it uncertain that an increase in the world price would even trickle down to the farmers themselves. Although Pedro knew it was not his decision to make, he felt obligated to help the Africans because they supported the dispute case. What could be done to make the West African cotton sector more competitive? How could the Francophone governments harness this window of opportunity to successfully promote development?
As Pedro looked at the questions he had written down, he realized that the answer to all of them required building consensus for a step-by-step path to break down the barriers between developed and developing countries. In everything Pedro read, everyone from trade analysts to NGOs cited the cotton case as a wake-up call to create a fair, mutually beneficial agricultural trading system that accommodated the needs of all countries. It was often referred to as a level playing field, but in reality the process was more like disarmament: no one wants to put down his weapons first. How could countries do it simultaneously? Pedro de Camargo hoped the cotton case could give WTO members a chance to do that.
Exhibit 1  WTO Dispute Panel Findings: United States Subsidies for Upland Cotton

(1) U.S. subsidy levels during the marketing years 1998–2002 exceeded the 1992 level. Therefore U.S. cotton programs were not protected under the Peace Clause.

(2) The panel found serious prejudice on the basis of price suppression for all price-based U.S. cotton programs, including:
   a. Marketing loss assistance payments (counter-cyclical payments in the 2002 Farm Bill)
   b. Marketing loan program
   c. Step 2 Program

(3) The panel found that U.S. support programs not tied to price did not contribute to price suppression. Those payments included direct payments (called production flexibility contract payments) and crop insurance payments. However, the panel ruled that because of the prohibition on planting fruits and vegetables, the direct payments did not qualify for green box, but should have been counted as amber box instead.22

(4) The panel rejected Brazil’s market share argument. That is, the panel ruled Brazil failed to show U.S. subsidies led to an increase in U.S. world market share.

(5) The panel found that the Step 2 program and the Export Credit Guarantee Programs (GSM) did contain an export subsidy element. Export subsidies were prohibited for all commodities except specific products for which countries requested special allowances in the Uruguay Round, called an “export subsidy base.”23 Since the United States did not have an export subsidy base for cotton, the panel ruled the United States should remove the export subsidy element contained in the GSM and Step 2 programs within six months.

22 A provision stated that if farmers grow fruits and vegetables on cotton base acreage, their payments would be penalized. Therefore, the panel argued, the direct payments were not fully decoupled from production levels, so they did not meet the criteria of green box. This same prohibition on fruits and vegetables existed for all program commodities that qualified for direct payments.

23 The US had export subsidy allowances for wheat, barley, vegetable oils, butter, cheese, beef, pork, poultry, and eggs. GSM programs used for all other commodities that have a zero subsidy base, such as corn, were given the same six-month timeframe to come into compliance with this ruling.
## Exhibit 2  Timeline of Key Events

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
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<tbody>
<tr>
<td>September 27, 2002</td>
<td>Brazil filed two dispute cases against U.S. cotton subsidies and EU sugar export subsidies at the Dispute Settlement Understanding (DSU), the legal arm of the WTO.</td>
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<td>April 30, 2003</td>
<td>The Francophone nations of Benin, Burkina Faso, Chad, and Mali filed the Sectoral Initiative on Cotton at the WTO.</td>
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<td>July 22, 2003</td>
<td>The first WTO panel session of Brazil vs. the United States on Upland Cotton Subsidies was held. The United States requested the case be thrown out, claiming U.S. cotton programs were protected under the Peace Clause. The panel rejected that request and allowed the case to proceed.</td>
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<td>September 10–13, 2003</td>
<td>The West Africans’ Cotton Initiative received widespread support in Cancun. The WTO Director General even chaired the negotiating session, but parties were unable to come to agreement. The Cancun ministerial adjourned prematurely after negotiators came to an impasse.</td>
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<td>April 22, 2004</td>
<td>The EU announced reforms of its support policies for Mediterranean products—hops, olive oil, and cotton—which included fully decoupling 65% of payments given to cotton growers.</td>
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<tr>
<td>April 26, 2004</td>
<td>The WTO dispute panel issued its confidential preliminary ruling, siding with Brazil on most of its claims.</td>
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<td>April 28, 2004</td>
<td>The House Agricultural Committee of the U.S. Congress held hearings at which Secretary of Agriculture Ann Veneman and U.S. Trade Representative Robert Zoellick assured lawmakers that U.S. support programs were consistent with WTO regulations. USTR Zoellick vowed to appeal the WTO ruling.</td>
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<td>June 18, 2004</td>
<td>The WTO dispute panel issued its final ruling, siding with Brazil that several U.S. support programs—including marketing loan payments, countercyclical payments, Step 2 payments, export credits, even direct payments—contributed to “serious prejudice” by depressing world cotton prices and recommended the United States eliminate or modify the offending programs.</td>
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<tr>
<td>July 24–31, 2004</td>
<td>Trade negotiators from the 147 WTO member countries met in Geneva to agree on a framework text for moving the Doha negotiations forward. After private negotiating sessions with the “Big Five”—U.S., EU, Brazil, China, and India—all 147 members agreed to substantial reforms in agricultural trade, including increases in market access, reductions in domestic support, and the elimination of export subsidies at an undetermined date. However, most significant details were left for negotiators to resolve at the Hong Kong ministerial in December 2005.</td>
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<tr>
<td>August 4, 2004</td>
<td>A second WTO dispute panel issued a preliminary ruling against EU sugar export subsidies in a case brought by Brazil, Thailand, and Australia.</td>
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Industry groups mostly praise WTO agreement

By MICHAEL HOWIE
Feedstuffs Managing Editor

“Applaud” was the word last week from most U.S. agriculture industry groups in response to a deal reached Aug. 1 between the 147 member countries of the World Trade Organization on a “Framework for Establishing Modalities in Agriculture.”

Groups applauded the U.S. team of negotiators, applauded negotiators from other countries who also pulled an all-nighter to reach the deal, applauded getting WTO talks “back on track” and just plain applauded the deal in general.

In any case, a deal has been struck, but many of the details are yet to be worked out.

“The road map is there,” said Sen. Chuck Grassley (R., Iowa). “Now, we have to fill in the details.”

Although a timeline to begin working on those details has not been set, it will likely be discussed at meetings next month.

U.S. Trade Representative (USTR) Robert Zoellick also noted that WTO “has laid out a map for the road ahead.” He added, “Next, we will negotiate the speed limits for how far and how fast we will lower trade barriers.”

The framework calls for an ambitious and balanced result through reform of trade-distorting agricultural subsidies, elimination of agricultural export subsidies and an improvement in market access for all farm products. In cutting farm tariffs, all countries other than the least developed will make a contribution, and deeper cuts will be made by those countries with higher tariffs.

Tariffs will be cut using a tiered formula that will lead to greater harmonization in tariff levels across countries, the USTR office said. Substantial improvements in market access will apply to all agricultural products, even “sensitive” products.

Developing countries, while part of the reform process, will be subject to lesser tariff reduction commitments. Wording on food aid was also changed, which was a relief to groups who see the U.S. as an important source of food aid in the world.

In the first year of implementing the WTO agreement, each member’s total trade-distorting support will be cut 20% from currently allowed levels, an amount equal to the cut of these subsidies during the entire Uruguay Round, USTR said.

Allen Johnson, USTR’s chief ag negotiator, noted in a press call last week that the U.S. is currently paying significantly less than the amount of trade-distorting support allowed. As a result, he said, “We’re confident we can manage that cut and confident we will see bigger cuts from Europeans than us,” he said. “Keep in mind that if we don’t find a package we agree with at the end of the day, we don’t have to sign off on it.”
On the sticky issue of cotton, WTO member countries agreed to address the issue within the agriculture negotiations. Previously, it was separated from the ag talks. As the G8 leaders recently affirmed, cotton is a matter of primary concern to African countries. Work on cotton will include all trade-distorting policies in the sector, including market access, domestic support and export competition. Discussions on cotton will occur in a subcommittee.

Response from the American Farm Bureau Federation (AFBF), although certainly supportive of the deal, which it said moves toward the goal of “expanding world markets for American agriculture,” was a bit more tempered. “The framework text does not settle all of the issues, but it provides the opportunity to continue to work toward agricultural trade liberalization,” said AFBF president Bob Stallman.

In a statement soon after the deal was struck, Sen. Tom Daschle (D., S.D.) said the deal was “a significant step backward for U.S. agriculture producers.” He said a 20% cut in farm subsidies would damage the farm safety net enacted as part of the 2002 farm bill. “In this deal, big agribusiness has won, and family farmers in South Dakota and across the country have lost,” he said. “It appears that the Bush Administration is selling out our farmers at the negotiating table.”

The National Farmers Union also did not see the deal as a significant move forward.

Grassley, however, said he felt it was “ironic” that some members of Congress would complain about a deal that could be about the only way to achieve “significant worldwide agriculture reform -- reform that is necessary if U.S. agriculture is to compete on a level playing field.”

**Congratulations aside, much work remains**

Agriculture Secretary Ann Veneman noted that the framework provides “a tremendous boost” for concluding the multilateral trade negotiations that will further open markets and reduce the barriers for farm products. She said the framework agreement indicates “the commitment of the member countries to a fair and equitable global marketplace” and provides a basis for an important set of new global agricultural trade rules.

Getting to those final rules, though, could take as much time and effort as it did simply agreeing to the framework. Moving past congratulations, the gist of many comments last week centered on the journey ahead.

“A great deal of hard work still lies ahead to finalize an agreement,” said Thomas M. Suber, president of the U.S. Dairy Export Council. “Although the talks could stumble and fall as further details are negotiated, this agreement injects new life into the process and helps put pressure on all of the parties to seal the deal in the future.”

“There is still much work ahead of us,” said National Corn Growers Assn. president Dee Vaughan.

Even Zoellick acknowledged that “there’s still a lot of work to be done.”

The National Grain & Feed Assn. (NGFA) and the North American Export Grain Assn. (NAEGA) urged negotiators “to redouble their efforts and use the framework to achieve aggressive, broad-based agricultural trade liberalization.”

Although congratulatory to the negotiators, NGFA president Kendell Keith and NAEGA president Gary Martin urged countries to use momentum generated by the framework “to bring about
substantial improvements in all three pillars of the agricultural negotiations: export subsidies, trade-distorting domestic supports and market access. The bar that would represent meaningful reform is quite high, and more needs to be done to achieve that objective.”

Keith and Martin noted that the approach outlined in the framework still leaves open to negotiation the precise timing, discipline and, in some cases, nature of the changes to trade-distorting practices and improvements in market access yet to be achieved. Still, the two groups were particularly supportive of the framework’s provisions that would eliminate all export subsidies as well as its call to end the trade-distorting practices of state-trading enterprises.

The AgTrade Coalition, which represents a broad spectrum of ag interests—including companies, livestock and poultry associations, grain and feed groups and some food interests, noted that the importance of advancing trade talks to the U.S. food and agriculture sector “cannot be overstated because these WTO negotiations, with the inclusion of virtually all of our major trading partners and all of their various trade restrictions, provide opportunities for worldwide trade liberalization that no other forum or trade negotiating venue can offer.”

The group added, “Difficult negotiations lie ahead, however, and the AgTrade Coalition will continue to work with government officials to ensure that U.S. interests and concerns are addressed.”

WTO deal on farm subsidies: New loopholes, vague promises

By IAN ELLIOTT
Feedstuffs Correspondent

When World Trade Organization member governments agreed on a new “Framework for Establishing Modalities in Agriculture” Aug. 1, they accepted a text on domestic supports that aims to settle concerns voiced by many countries.

Complaining countries said they are able to compete against American, European and other farmers, but not against the wealth of their rich governments. The Aug. 1 text aims to answer that.

In June, the Organization for Economic Cooperation & Development (OECD) estimated that the world’s richest 30 governments -- the European Union’s 15 governments count as one—spent $257 billion in 2003 on domestic farm subsidies, most of it by propping up market prices that subsidize downstream industry. The bulk came from the U.S. ($38.8 billion), Japan ($44.7 billion) and the EU ($121.3 billion). WTO, for some reason, does not make public a similar comparison for all 147 members.

Currently, farm subsidies fall into three WTO boxes: trade-distorting “amber” (used by about 30 rich and poor countries), “blue” (less trade distorting since linked it is to production limits) and “green” (permitted).

The key question before government ministers July 31 was whether they could come up with a formula to produce “substantial reductions in trade-distorting domestic support.” When all 147 governments agreed to the text, they said they had.

20% cut first year

Ministers plan to accomplish these “substantial reductions” by first giving farmers in poor nations a longer time to cut fewer of their subsidies than farmers in rich countries. For rich countries, those paying the highest subsidies will have to cut the most from already-promised ceilings.

(Farmers in poor countries, including some of the world’s largest exporters of farm commodities like Brazil and China, get special treatment throughout the WTO framework.)

Governments want “substantial reductions” in all trade-distorting amber box and “de minimis” subsidies (5-10% of the value of production) and a cap on blue box programs.

The governments plan to use a “tiered formula” to do this, with a 20% down payment in the first year after negotiations finish.

Much of the important detail on how to accomplish all of this has been left for later.
Blue box loophole

On the blue box, governments gave their negotiators more detailed instructions, providing what some worry could become a major loophole.

Currently, countries can only use these subsidies when a farm program limits production—set-asides and quotas. This essentially keeps subsidized production out of global markets.

The Aug. 1 text said countries would still be allowed to use the blue box if programs are production limiting based on “fixed and unchanging” yields, areas or animal numbers. Again, the volume of subsidized product flowing into global markets is limited.

Mostly at the insistence of the Bush Administration, however, governments added that farm programs that “do not require production” can now qualify in the blue box if they meet the same “fixed and unchanging” measurements.

This suggests that governments could easily use blue box subsidies to fund “real” as well as “paper” farmers—those whose only connection to farming comes through the check in their mailbox.

This new loophole appears to do little to prevent subsidized production from flowing into world markets. All a paper farmer needs do is rent out his production facility and collect a subsidy—an enticement an aging, inefficient or undercapitalized producer may well grab.

Finally, the 147 governments agreed that: “Blue box support will not exceed 5% of a (WTO) member’s average total value of agricultural production during a historical period. The historical period will be established in the negotiations. This ceiling will apply to any actual or potential blue box user from the beginning of the implementation period. In cases where a member has placed an exceptionally large percentage of its trade-distorting support in the blue box, some flexibility will be provided on a basis to be agreed to ensure that such a member is not called upon to make a wholly disproportionate cut.”

On the green box, governments told negotiators to simply review and clarify existing rules—no caps, no cuts.

Exhibit 5  The Uruguay Round Agreement on Agriculture

The objective of the Uruguay Round Agreement on Agriculture (AoA) was to reform agricultural trade towards more market-oriented policies for exporting and importing countries alike. After eight years of negotiations, it took effect in 1995. Developed countries had to make scheduled cuts in their subsidies and tariffs over a six-year period, while developing countries had smaller tariff reduction requirements and a 10-year timeframe to implement them. Least-developed countries (LDCs) were exempt from undertaking any reforms.

The provisions in the Agreement on Agriculture called for reforms in each of the “three pillars” of agricultural trade:

(i) Market access.

Developed countries had to cut their tariffs by an average of 36% with a minimum cut of 15% for any product; developing countries had to make an average cut of 24% with a minimum per product cut of 10%.

(ii) Export Subsidies.

Export subsidies are widely considered to be the most trade-distorting type of support because they encourage producers to export their products onto world markets at less than the cost of production, also known as “dumping.” The AoA prohibits export subsidies except for specific subsidies listed within members’ commitments, and even then the agreement requires countries using export subsidies to cut both the amount of money spent on them and the number of exports that receive them.

(iii) Domestic support.

The AoA essentially said that not all subsidies are the same: some distort trade, while others do not. Accordingly, the agreement distinguished between distorting and non-distorting types of support policies by assigning them to color-coded “boxes:”

- **Green box.** Green box subsidies have a negligible, or at most minimal, effect on trade. These types of subsidies are not subject to reduction commitments; in fact, countries could increase their green-box spending without restraint, provided that the payments meet the green-box requirements. Green-box subsidies include government transfers for research and environmental conservation, as well as direct income payments to farmers that do not influence production decisions (i.e. the amount of acreage planted or the type of crop grown).

- **Blue box.** Under the AoA, blue-box programs are not subject to reduction commitments on the grounds that they are not tied to current production. They include rural development programs, direct payments that require farmers to limit production, and decoupled payments given to farmers based on their historical, not current, production levels.

- **Amber box.** All domestic support programs that do not meet the criteria of one of the two categories above are considered amber box. These include price supports, coupled payments, product-specific programs, and input subsidies. Amber box subsidies are considered highly

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24 The three criteria for a subsidy to be considered green box are: (1) the subsidy must not distort trade, or at most have a very minimal distorting effect, (2) it must be government-funded, and (3) it cannot involve a price-support mechanism.
trade-distorting because they have a direct effect on production levels, and as such they are subject to reduction commitments under the AoA. Using 1986–1988 as a reference period, WTO members calculated their annual spending on these types of programs, a figure that is referred to as the “total aggregate measure of support” (or AMS). Each country’s AMS became the maximum allowable level it could spend on amber box programs annually, and starting in 1995, developed countries agreed to reduce their total AMS spending by 20% over six years. Developing countries agreed to make a 13% cut over ten years.

The Peace Clause

Though countries agreed to lower tariffs and subsidy levels over a number of years, there was still a concern about how the Agreement on Agriculture would relate to other Uruguay Round agreements, such as the Agreement on Subsidies and Countervailing Measures (ASCM). The ASCM essentially laid out the terms and conditions under which countries have recourse to impose penalties on other WTO members whose policies are inconsistent with their WTO commitments. For example, a subsidy given to producers in one country that causes “serious prejudice” (i.e. substantial financial harm) to a domestic industry in another country is actionable under the ASCM. Both parties present their arguments before a three-person panel in the Dispute Settlement Understanding (DSU), the court system of the WTO. If after a series of panel hearings the subsidizing nation has been found to cause serious prejudice, it must remove the offending subsidy or face retaliation from the country that brought the case.

The question of which agreement took precedent—the AoA or the ASCM—was no small matter. Even though the AoA allowed WTO members to maintain a certain level of trade-distorting agricultural support (their AMS), would they still be open to legal challenges from other countries as long as serious prejudice could be proved? Some WTO members, most notably the United States and EU, wanted extra protection against challenges of their agricultural subsidies, so they pushed to include a clause in the AoA encouraging countries to “exercise due restraint.” Article 13, commonly referred to as the Peace Clause, effectively prohibited WTO members from bringing countervailing duty cases against other members’ agricultural subsidies. Specifically, Article 13 stated that:

(i) Green box subsidies could not be subject to cases under the ASCM agreement.

(ii) Blue box and amber box subsidies were exempt from countervailing duty cases, as long as a country’s overall AMS commitments did not exceed its 1992 levels and the amount of support given to a specific commodity did not exceed the level decided in the 1992 marketing year.

The nine-year Peace Clause took effect in 1994 and expired on December 31, 2003. Developed countries had hoped to renew the Peace Clause at the Cancun ministerial in September 2003, but the talks collapsed and the clause was allowed to expire at the end of the 2003 calendar year.

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25 Twenty-eight WTO members (counting the EU as one member) had non-exempt, or amber box, domestic support programs that were subject to reduction commitments.

26 According to the ASCM, serious prejudice exists if the subsidies of a WTO member:

1. Displace or impede imports by the subsidizing country; or
2. Displace or impede the exports of another country in a third country market; or
3. Result in price undercutting, price depression or price suppression; or
4. Lead to a loss of world market share for a competitor country. (DTB Associates, LLP, 2004.)
The precursor to modern day cotton programs came out of New Deal legislation, the Agricultural Adjustment Act of 1933, which set up a system of minimum prices and government stocks. The main form of government assistance was the marketing loan program, which established “loan rates” for different commodities, or minimum prices that farmers could enjoy. The objective was to allow market conditions to take over in good years, while providing a safety net for farmers in times when there was a sudden downturn in price.

At the time of harvest, farmers received loans that were equal to the loan rate times their actual production, called “non-recourse loans” because the government had to accept the production in lieu of repayment. The loan rates of any given commodity were set to cover the costs of production, with the intention of giving farmers the choice between transferring their harvest back to the government to pay off their loan or selling their crop on the open market—whichever had the highest returns. However, after World War II, many of the loan rates were set so much higher than the cost of production that the government essentially became the market, not the customer.

In the 1960s, U.S. Congress lowered the loan rates to “disaster levels,” meaning the market once again determined the crop value. The United States became more competitive in global agricultural markets as a result. Since that time U.S. Farm Bills have tried to preserve a market orientation rather than relying on government interventions, while still employing policies that maintained a safety net for farmers in stressful times of drought or low prices. With inflation running high in the late 1970s, loan rates were set at very high levels. In the 1980s, due to an appreciating dollar and a slump in world GDP, world markets collapsed, leaving loan rates at very high levels relative to market prices. Large loan forfeitures resulted in enormous government stockpiles, stimulating Congress to legislate reforms in the 1985 Farm Bill, which lowered loan rates considerably and ultimately set the stage for the 1996 Farm Bill.

Freedom to Farm: The 1996 Farm Bill

The House and Senate Agricultural Committees draft farm legislation, commonly called Farm Bills, every five to six years, which must be subsequently authorized by Congress and approved by the President. Farm legislation came up for renewal in 1996, and for the first time, U.S. legislators faced an international constraint on their domestic farm policy: WTO commitments the United States agreed to in the Uruguay Round. Price-based support programs such as loan deficiency payments, introduced in the 1985 Farm Bill, were considered amber box because they were tied to the production of a specific commodity.

Moreover, program outlays were impossible to determine in advance because the marketing loan payments to farmers depended on what world prices were doing. As a result, government spending often varied dramatically from year to year. Yet such volatility could lead to spending that was incompatible with the United States’ WTO commitments. When the AoA was implemented in 1995, the United States’ total AMS, or permissible amber box support, stood fixed at $19.1 billion a year.

However, the mid-1990s were a period of record high commodity prices. Because U.S. farmers were doing well on the world markets, U.S. government outlays under the marketing loan program and other price-based subsidies were minimal. “The loan rates at the time—not just for cotton, but for all the commodities—were way below market prices,” commented Joe Glauber, Deputy Chief
Economist at the USDA. “In 1995–1996 . . . [the U.S.] was reporting [AMS] outlays of $7-$8 billion. We were well within our limits, and everyone felt that we were looking pretty good.”

U.S. Congress used the opportunity to pass the Freedom to Farm Act, which introduced a system of “decoupled” direct payments. The marketing loan program remained more or less intact, but it did not raise much concern since world prices were so much higher than loan rates at the time. In general, the 1996 Farm Bill was applauded as a step in the right direction. Direct payments were designed to qualify as green box, since the payments were based on historical production levels (i.e., “base acreage”), not actual production on the farm. Because farmers received direct payments regardless of whether they planted cotton, planted something else, or put their land into fallow, legislators argued, they met the green box criteria of not distorting production. There was one exception, however. Farmers’ direct payments would be reduced if they planted fruits and vegetables on their base acreage.

**Congress Passes Supplemental Legislation**

In 1997–1998, the bottom fell out of commodity markets, due mainly to the East Asian financial crisis. The dollar rose, leading to a loss of U.S. competitiveness that dampened demand for U.S. goods across the globe.

Reeling from depressed world demand and facing a severe drought in several U.S. states, Congress passed supplemental legislation in 1998 that authorized additional “emergency” payments to farmers of $30 billion over a four-year period. Congress was criticized by supporters of the 1996 Farm Bill for reverting back to the old system of price supports. “At the same time the U.S. was in Geneva saying how decoupled our programs were,” said Joe Glauber, “Congress was passing supplemental legislation to compensate producers for low prices.”

Cotton prices were still relatively high when Congress passed the supplemental legislation. Nevertheless, because the emergency payments were designated for all U.S. farmers, not just those hardest hit by drought or low prices, U.S. cotton farmers received the extra payments as well. The emergency payments, called the marketing loss assistance payments, were “done in an imprecise manner,” said Joe Glauber. “In 1998, corn and wheat guys were hurting, they got double payments. Cotton and rice guys were doing pretty well, but they also got double payments. It really didn’t match the need.”

In 2000, Congress passed the Agricultural Protection Act (ARPA), which provided an additional $8 billion in subsidies to U.S. farmers under the crop insurance program, for which cotton growers were eligible. Months later, when the world price of cotton fell below the loan rate of 52 cents, the marketing loan payments kicked in. All told, government support to U.S. cotton growers totaled $1.9 billion in 1998–1999, $3.5 billion in 1999–2000, $2.1 billion in 2000–2001, and $3.9 billion in 2001–2002. In contrast, the amount of assistance that U.S. cotton growers received in 1992, the baseline marketing year for the purposes of the Peace Clause, was $1.4 billion (Table A).

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27 Cotton was one of the last commodity markets to be affected by the Asian financial crisis. Whereas other commodity markets bottomed out in 1998-1999, cotton prices were relatively stable until 2000. Although the cotton crop in Texas was in fact affected by the drought, producers received disaster payments on top of the marketing loss assistance payments.

28 These totals include direct payments, marketing loan payments, Step 2 payments, crop insurance payments, and payments under the export credit guarantee program. Bafles, 2003, p. 13.
The 2002 Farm Bill

In sharp contrast to the previous three farm bills, the 2002 Farm Bill was passed in a time of government budget surplus. By all accounts, it was a strong reversal of the 15-year trend away from decoupling producer support to production levels. Significantly, the “emergency” marketing loss assistance payments became permanent in the 2002 Farm Bill, now termed countercyclical payments. Like direct payments, countercyclical payments were based on historical, not actual, production levels. Like marketing loan payments, they kicked in only in years of low prices, when the world price fell below the minimum price. In 2002, for example, a year of low cotton prices, counter-cyclical payments immediately became the largest component of government assistance to cotton growers, totaling $1.3 billion dollars, or 36 cents of every dollar spent.

The projected outlays for the 2002 Farm Bill were $180 billion over a 10-year period, representing an 80% increase in spending from the 1996 Farm Bill. “All of a sudden we have a very big program again,” said Joe Glauber. “Now we’ve increased the loan rate in an environment where prices are expected to be low, . . . the direct payment rate was increased for most commodities, and on top of that we had these countercyclical payments.”

Table 6A  U.S. Government Support to Cotton Producers (in millions of dollars)

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<tr>
<td>Coupled payments (e.g., marketing loan and loan deficiency payments)</td>
<td>$535</td>
<td>$1,613</td>
<td>$563</td>
<td>$2,507</td>
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<td>Production flexibility contracts/direct payments</td>
<td>637</td>
<td>614</td>
<td>575</td>
<td>474</td>
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<td>Marketing loss assistance payments/ countercyclical payments&lt;sup&gt;b&lt;/sup&gt;</td>
<td>316</td>
<td>613</td>
<td>613</td>
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<td>Crop Insurance</td>
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<td>170</td>
<td>162</td>
<td>236</td>
<td>194</td>
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<td>Step 2 payments</td>
<td>308</td>
<td>422</td>
<td>236</td>
<td>196</td>
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<td>TOTAL</td>
<td>1,946</td>
<td>3,432</td>
<td>2,148</td>
<td>3,964</td>
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<td>U.S. Production (thousand tons)</td>
<td>3,251</td>
<td>3,823</td>
<td>3,742</td>
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<td>Government assistance (US$ per kilogram/percentage of A Index)</td>
<td>0.58/45%</td>
<td>0.91/78%</td>
<td>0.59/47%</td>
<td>0.82/89%</td>
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<tr>
<td>World price ($/kilogram)</td>
<td>1.30</td>
<td>1.16</td>
<td>1.26</td>
<td>0.92</td>
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</table>


<sup>a</sup>The 1992–1993 marketing year served as the threshold level which countries could not exceed to remain protected under the Peace Clause.

<sup>b</sup>The emergency marketing loss assistance payments, which Congress authorized in supplemental legislation in 1998, became permanent in the 2002 Farm Bill under the new name countercyclical payments.
**Figure 6A**  Government Subsidies as a Percentage of Farm Income, by Farm Size and Commodity Group, 1998


**Figure 6B**  U.S. Area Devoted to Cotton Production, 1990–2003

Figure 6C  World and U.S Cotton Trade

Exhibit 7  The World Cotton Market

Cotton Supply

In 1960, global cotton production totaled 10 million tons. That figure had doubled to 20 million tons by 2001. Major cotton producers include the United States and China (together comprising 40% of world production), as well as India (12%), Pakistan (8%), Uzbekistan (5%), Francophone Africa (5%), Brazil, Australia, Turkey, and two members of the European Union, Greece and Spain. One-third of cotton is traded internationally, with the United States by far the world’s largest exporter. Behind the United States, major cotton exporters are Uzbekistan, Francophone Africa, and Australia (Table A).

Cotton production has undergone dramatic technological changes. Improved seed varieties, fertilizers, pesticides, and mechanical farming have lowered costs and doubled world cotton yields between 1960 and 2000, from 300 to 600 kilograms per hectare. The development of a genetically modified cotton plant designed to protect itself from insects has also transformed the sector. Since Monsanto first introduced its genetically engineered strain in 1996, called Bollgard (Bt) cotton, it has been adopted in nine countries and is now grown on thirteen million hectares worldwide, or 40% of total acreage devoted to cotton.

Countries that grow Bt cotton include the United States (where Bt accounts for 70% of total cotton acreage), Australia (40%), China (20%), as well as India, Indonesia, Mexico, Argentina, Colombia, and South Africa. Although the EU cites health and environmental reasons for not switching Bt cotton, its adoption has significant implications for farm income, especially for developing countries. It results in higher yields due to less insect damage, and higher profits (because fewer sprayings lower input costs).

Cotton Demand

Global consumption patterns for cotton fiber are determined by several factors, the most significant of which is the size and health of the textile industries in cotton-importing nations. China is the largest textile-producer in the world, consuming over one-quarter of global cotton output during the 1990s. Along with China, the textile industries of the United States, Turkey, and India together account for three-quarters of cotton consumption.

Though much of the 1990s saw steady, if slow, increases in world cotton demand, cotton experienced a sharp price decline after the East Asian financial crisis in 1997. Inflation rose, demand shrank, and many mills sat idle in the textile-producing East Asian nations of Indonesia, Thailand, Taiwan, and Korea. By 2002, once their economies rebounded, those four countries together absorbed 22% of global cotton output. A second factor affecting cotton demand is the increasing competitiveness of chemical fibers. Consumption of synthetic fibers such as polyester grew by 4.7% annually from 1960 to 2000 as technological innovations allowed them to be produced more cost effectively. In contrast, cotton consumption grew by only 1.8% annually over the same time period, or roughly parallel to population growth. While in most countries, per capita demand for cotton textiles

29 Cabanilla 2003.
has been declining, the United States is the only country in the world where cotton consumption has been increasing for the last 10 to 15 years.

Table 7A  Global Production and Consumption of Cotton Fiber, 1997–2005 (Projected)

![Table 7A: Global Production and Consumption of Cotton Fiber, 1997–2005 (Projected)](image_url)

Market Distortions and Policies

The most significant distortions in the world cotton market stem from the large amounts of subsidies that countries funnel to their domestic producers (Tables B-D). In addition to domestic support, some cotton-exporting countries maintain a policy of taxing cotton imports in the form of tariffs or tariff-rate quotas (TRQs). Argentina, Brazil, Egypt, India, Uzbekistan, and Zimbabwe impose tariffs on cotton imports ranging from 5% to 15%. The United States has a TRQ that imposes a tariff of 4.4 cents/kilogram within quota and 31.4 cents/kilogram outside quota (with a TRQ of 73,207 tons). China has a TRQ of 3% within quota and 90% outside quota (with a TRQ of 856,250 tons).

Figure 7A  Worldwide Assistance to Cotton Producers, 1997–2002

![Worldwide Assistance to Cotton Producers, 1997–2002](image)


Figure 7B  World Production under Direct Assistance, 1997–2002

![World Production under Direct Assistance, 1997–2002](image)


<table>
<thead>
<tr>
<th>Country</th>
<th>1997/98 Production</th>
<th>Average Assistance per Pound Produced</th>
<th>Assistance to Production</th>
<th>1998/99 Production</th>
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Source: International Cotton Advisory Committee 2002.

Table 7C  Worldwide Government Assistance to the Cotton Sector, 1999–2000 and 2000–2001

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<tr>
<th>Country</th>
<th>1999/00 Production</th>
<th>Average Assistance per Pound Produced</th>
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*Income and price support programs only. Credit and other assistance not included.
**Preliminary.

Figure 7C  ICAC Simulation Model: World Production With and Without Subsidies

Source: International Cotton Advisory Committee 2002.
**Figure 7D**  ICAC Simulation Model: World Price With and Without Subsidized Production

Q. The U.S. has several support programs in place for cotton growers, one of which is the countercyclical program. Critics of countercyclical program believe the payments shield producers from market signals by providing a price floor, while supporters say the program does retain a market orientation, provided the target prices remain well below market prices. What is your opinion of countercyclical programs? Are they market-oriented or not?

A. In terms of distorting effects, you have to look at these programs on a continuum. Direct payments that are not tied to price or production would be at one extreme. The least distorting form of support would be a decoupled payment program that transfers benefits to individuals (rather than the farm) and that are transferable to others. These benefits are decoupled and are less likely to get capitalized into land values. However, programs like that are pretty hard to develop, unless they are run as one-time buy-out type programs like the peanut quota buyout payments in the 2002 farm bill.

At the other extreme, you have marketing loan payments—where you do not get the payment unless you produce, and the payment is directly tied to price. The countercyclical payment program is somewhere between those two.

The marketing loan program is “countercyclical” in that it pays producers when prices fall below the loan rate. We have always considered those programs to be highly distorting, because they are tied to actual production. They are reported as part of our cotton AMS and really started skyrocketing for cotton in 1999 or 2000 as cotton prices fell worldwide. They are distorting because a producer knows at planting that he or she will receive the loan rate for every pound of cotton produced.

Countercyclical payments were introduced in the 2002 Farm Bill. We had a similar program prior to the 1996 Farm Bill called the deficiency payments that were administered in conjunction with acreage set aside programs. Countercyclical payments pay producers the difference between an administered price—the target price—and the higher of average marketing year price or the loan rate plus the direct payment rate. The difference between the countercyclical payment program and marketing loans is that countercyclical payments are based on historical production. Under this program, you don’t have to produce a crop to receive the payments. They still allow producers to make marketing decisions and planting decisions based on market prices and not on the payment. Producers will get the payment regardless of whether or not they plant cotton; regardless of whether they harvest 500 pounds of cotton per acre or 600 pounds per acre. From that standpoint, we’ve argued that they’re far less distorting.

Brazil’s case was [countercyclical payments] were distorting because they are cotton payments, and because they are additive. They argued that if you add countercyclical payments to direct payments and marketing loan payments, the sheer size of the total payments going to cotton farmers is distorting. That is a somewhat separate issue. I think the level of support is a potential distortion if you consider it in the aggregate sense of all payments on the farm. Economists have argued that the size of the payments may have a wealth effect on farms. That is, being in the cotton program, you get a lot of payments, and because of the large magnitude of these payments, they have a potential effect on the financial operation of your farm. The point the U.S. raised in their submissions is that while large decoupled payments may keep you in production, they do not necessarily keep you in cotton production. They don’t give you any incentives to plant cotton over any other crop. It may keep you...
in business as a farmer, and that may be significant, but it doesn’t mean that you will remain a cotton farmer.

Brazil has made the argument that both direct payments and countercyclical payments are linked to production because producers have incentives to continue to grow cotton based on expectations that future payments will be based on what is grown today. Their argument is “What happens if I go years and years and years and I don’t plant cotton but I keep planting soybeans? I follow market signals. Will I lose program benefits?” That is the presumed problem with base updating—is there some indirect link there, psychological or otherwise? The evidence would tend to refute that notion. There is a lot of area eligible for cotton payments, but as the U.S. pointed out in their submissions, a significant portion has not been planted to cotton in recent years. Thirty percent of the cotton base area was planted to other crops or left idle in 2002. I would argue that at the margin, farmers are responding to market signals not the cotton target price.

Q. There is an inherent tension between U.S. domestic farm policy and our WTO commitments. Many U.S. support programs, like the marketing loan program and countercyclical payments, are designed to kick in only when world prices fall below a certain level, meaning that government outlays can vary dramatically and unpredictably from year to year. Yet the U.S. has a fixed AMS commitment that, according to the July framework text, is subject to additional reductions over the next several years. How significant is this tension between variable outlays and fixed WTO commitments for U.S. policy-makers?

A. The way domestic support programs are measured for AMS purposes poses a methodological problem for programs that are contingent on market price levels. Commodity prices are highly variable. Because of this programs such as marketing loans and countercyclical payments can vary significantly from year to the next, even though the underlying support price or target price has not changed. One year, outlays are zero, the next year they run $6 billion. What is the right measure? The program itself has not changed over that period. If you look at the cotton program, the loan rate did not change much from 1996 to 2002. Marketing loan outlays for cotton were close to zero from 1996 to 1998, and then skyrocketed as prices fell in 1999 and 2000. Are actual outlays the proper measurement or would a better measure be the option value of the marketing loan program?

The point that the U.S. made repeatedly in its WTO submissions was that the proper way to measure the level of support is ex ante, at the time of planting. The fact that a payment is high or low at the time of harvest depends on largely exogenous factors—the level of Chinese stocks, world GDP, exchange rate fluctuations. The size of the payments may have little resemblance to the expected payment at the time of planting.

Unfortunately, the methodologies used by members for reporting domestic support (AMS) commitments tend to be based on actual outlays because of the ease of reporting and ease of verification. An option price that measures the ex ante value of a marketing loan rate may be a far better measure in theory, but in practice, it would be far more difficult to get international agreement among members because of the complexity of the concept.

During the 2002 Farm Bill debate, my office calculated the probability of exceeding WTO limits. FAPRI\(^\text{30}\) also did an analysis that was published shortly after the Farm Bill was passed. You hear quotes from some that ‘when Congress passed the 2002 farm bill, they were assured that it would not exceed WTO limits.’ Well, that is false. At the time, USDA and FAPRI were saying the Senate version

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\(^{30}\) The Food and Agricultural Policy Research Institute was established by U.S. Congress in 1984 and is jointly run by two universities—Iowa State University and the University of Missouri at Columbia.
of the bill had a very significant probability of exceeding limits. Even the House bill that was passed had a 20% or 30% likelihood that sometime over the life of the Farm Bill, we would exceed our WTO limits.

The implications of the July framework agreement means a much smaller AMS for the U.S. While there were no real numbers attached to the draft, there was an implicit understanding among members that the U.S. and the EU would substantially reduce their AMS commitment. A 50% reduction, for example, would mean reducing our AMS level down to $9.6 billion (from the current commitment level of $19.1 billion). Given the current farm bill, this would imply a significant probability of exceeding the new AMS commitments unless farm prices were to remain well above loan rates.

If you were to look at our AMS outlays for the past several years, you see that dairy is very costly. It’s about $4.5 billion annually and has trended up over time because it is based on milk production which is trending upwards. Like dairy, the sugar AMS is calculated on the basis of a price gap and it runs about $1 billion every year. That is $5.5 billion on price support commodities alone. So if we face a new AMS commitment of $9.6 billion, you are really talking about a only $4 billion or so to cover marketing loan and loan deficiency payments. The variability of these programs is enormous, with marketing payments outlays going from zero to over $8 billion over the past few years.

There is a provision in the 2002 farm bill that requires the secretary to take action if it looks like we are going to exceed WTO limits. This is the so-called circuit breaker provision. But there are two problems implementing the circuit breaker. One is an equity issue. Who gets cutbacks in payments? Do you try to cut support equitably across all commodities? Or do you cut only those commodities where outlays are the largest or where there is the largest deviation from expected levels? The other problem is timing. Support payments that go into the calculation of the total AMS are not spread equally across the year. Some commodities get payments early in the year. Others receive payments later in the year. The AMS for dairy and sugar is calculated over a 12-month period starting in October. The AMS for marketing loans is calculated over the loan period— which may be as long as 18 months. Consider 2004. At planting time, it looked like we were going to have a total AMS of $8 billion. Last spring, futures prices for harvest delivery suggested high market prices this fall and hence small marketing loan outlays. It is anyone’s guess right now what it will be, but market prices have slid a lot over the summer, due to ideal growing conditions for many of these crops. So now what do you do? It is clear that our AMS for 2004 will likely be greater than $8 billion, but we won’t have a good idea of what our AMS will be until January or February. While it unlikely that we will be close to our $19.1 billion limit, the point is that by February we will have already made a lot of payments, and it is hard to get those back once they are paid. It is far easier to take a single program like countercyclical payments which are paid at specific points during the year, but again, that raises equity issues since you are only affecting those commodities eligible of countercyclical payments.

Q. Will the framework text that came out of the July negotiations contribute to significant reform as far as domestic support is concerned?

A. As far as domestic support is concerned, the key thing is the reduction in the AMS. The U.S. marketing loan programs and high EU intervention prices are the perhaps the most distorting forms of support. Anything that can be done to eliminate marketing loans, or at a minimum reduce support prices far below market clearing levels so that they are truly a safety net would be a very positive thing for the rest of the world. The same is true for invention prices. To the degree possible, producers should be reacting to world prices, not artificial ones.
Under the July framework, it looks like green box criteria may be reviewed, but it is not expected that there will be much change. No one was all that keen on making any large revisions. The G-20 and Cairns group were interested in disciplines on the green box, but ultimately I think most felt that they could live with green box payments as long as they are decoupled from price and production.

The good news about the blue box is it is capped, but it is unclear what the reduction commitments would ultimately be. Some of the drafts from the G-20 really wanted to lay out clearly that the blue box cap—at 5% of the value of production—would be a starting point, and reduced to 3% over time. Capping it is a big first step, as is making sure countries cannot update bases and yields. Just like green box criteria, the new blue box criteria imposes payments based that are fixed and unchanging. That is significant, because it bolsters the fact that countercyclical payments are based on historical production. It gives people far more incentives to produce on market signals rather than the administered target prices of those countercyclical payments.

Brazil and others would certainly like to see further disciplines on the blue box, particularly given the preliminary ruling on the cotton panel. I think many other countries accepted the argument that as long as the payments were based on historical production levels and were capped, they could live with it. It will be interesting to see how negotiations proceed this year.

Many countries view the domestic support provisions as simply “box shifting”—moving amber support to blue with very little net effect in terms of liberalization. But I would argue that the disciplines will mean a less trade-distorting environment because it will force more disciplines on the way the payments are made. Shifting out of amber will force more production to be based on market signals.

There are caps on product-specific AMS, which means that you cannot allow one commodity to get more than during a base period, so a country will not be able to increase support for one commodity while ensuring that overall AMS levels are within their commitments. That is a really positive thing. There are reductions on overall AMS, a cap on the blue box, a significant \textit{de minimis} reduction, and then an overall reduction commitment on \textit{de minimis} plus blue box plus amber. All of those disciplines and reduction commitments end up with pretty significant reforms on domestic support, or at least moving it to less distorting forms, depending on what numbers are plugged in.

Lastly, as far as the export credit guarantee programs are concerned, I think the July agreement is in lockstep with the cotton panel’s decision. Export credits will be significantly disciplined by removing the subsidy component. Assuming that the panel decision’s is upheld, the GSM program will have to change long before we get a WTO agreement, but I think it will be done in a way that will make it far less distorting. There are other export credit programs out there other than the U.S. programs, and I guess to a degree they will all be affected once an agreement is reached. I think that is consistent with the cotton panel decision.

Q. In the Uruguay Round and even at Cancun, the EU was charged with being the “bad guy”—the one blocking serious reforms in the agricultural sector—while the U.S. issued calls for greater liberalization. Yet at the July 2004 negotiations, many policymakers and reporters made a big deal about the swap between the U.S. and EU positions. In the weeks preceding the talks, the EU offered concessions on export subsidies, while the U.S. was perceived to be “on the defense” regarding its domestic support programs. Is this a fair characterization of the two positions, and the shifting that has occurred?

A. Our WTO negotiating proposal in 2000 really set the EU up as the bad guy, and they have been a convenient bad guy for twenty years at least. From my perspective, the reforms the EU has put in
place over the past ten to fifteen years have been substantial, even exceeding ours (particularly considering how distorting their policies were in the late 1980s). One could argue their programs are as market-oriented as ours. They continue to subsidize at very high levels, but again, now largely in the form of decoupled, non-distorting forms of support.

I think there is little doubt that they were better positioned for this round of negotiations, particularly compared to the U.S. who all of sudden in the 1999, 2000 and 2001 found itself with AMS levels near their current commitments and with a farm bill that increased support. In its 2000 WTO proposal, the U.S. called for the elimination of the blue box (Article 6.5). Since the EU was the major user of the blue box, it put them on the defensive. I think it led EU commissioner Franz Fischler to the conclusion that the EU needed to pass further reforms that further decoupled their compensatory payments to allow them to shift them from blue box to green box. The Mid-term reforms passed last year will enable them to do this and substantially reduce their blue box levels. This is very positive for world agriculture and I think the U.S. can take some credit for it.

The result was that the reforms left the EU in an enviable position vis-à-vis the domestic support negotiations. It enabled them to come into the negotiations a year ago with calls for 55%-60% reduction in AMS levels. Ironically, our own domestic policies put us at odds with our WTO obligations. We were having trouble meeting the current $19.1 billion commitment level, let alone accepting a further 55%-60% cut. One of the problems was the highly variable nature of our payments, particularly the counter-cyclical payments. By last summer, the U.S. position was pushing for a “new” blue box that would accommodate our counter-cyclical payments. It put the U.S. in the position of demandeur in the WTO—i.e., we needed a redefined blue box. The July framework gives us a new blue box. It is unclear what price will ultimately be paid for the accommodation.

Q. When asked about the role of Brazil’s dispute cases in the immediate wake of the July negotiations, the statements of USTR Zoellick and EU Commissioner Lamy seemed to be at opposite ends of a spectrum. What role do you think Brazil’s dispute cases against the U.S. and EU had in the July negotiations?

A. Ambassador Zoellick has argued that dispute settlement is an inherently unsatisfactory process for the plaintiffs. This certainly has been the U.S. experience on some of cases that it has won (e.g., beef hormones), and may ultimately be unsatisfactory for Brazil as far as cotton and sugar are concerned as well. Even presuming the panel findings are upheld, there still is the prospect of coming into compliance. If other panel rulings are a guide, we will likely be back in Geneva arguing over some of these issues in the future. That is why Bob Zoellick has argued that it is far preferable to seek multilateral agreement on disciplines.

There is also the political side and here I think that there is no question that these disputes have played a very large role and one that many would agree is a positive one for the WTO. The cotton and sugar cases have raised the visibility of domestic support issues.

Ultimately, however, I don’t think that the outcome is much different that what was anticipated in the closing days of Cancun. Most of the domestic support text was hammered out in the Harbinson text and the EU/U.S. agreement prior to Cancun. Tim Groser did a remarkable job pulling together the EU, U.S., Brazil, India and others in crafting the July text. He was able to clear up some of the misgivings some of the countries had regarding the new blue box and he was able to get concessions from the U.S. and EU that satisfied members that substantial progress would be made.

As far as the cotton initiative is concerned, the July framework would suggest that reforms will be made in the context of an overall WTO agreement—including domestic support. In one sense, the
language is very similar to the Cancun language—with the important exception of the removal of the offensive phrasing on helping countries diversify away from cotton.

Source: Interview with USDA Deputy Chief Economist Joe Glauber.
Exhibit 9  Iowa Agricultural Review Analysis of Panel Ruling
Exhibit 9 (continued)

QuickTime™ and a TIFF (LZW) decompressor are needed to see this picture.

Source: Add source.
Exhibit 10  Impact of 20% Reduction in Overall Trade-Distorting Support: United States, European Union, and Japan

The tables below illustrate the impact of a 20% down payment reduction in trade-distorting support, if 2000 were the base year for the cuts. Japan would not have been required to make any cuts in amber, blue or *de minimis* to meet the overall reduction commitment. The EU would have to reduce blue box spending from 22.2 billion Euro to 12.1 billion Euro, but would have plenty of room in its amber box, or the green box, to shift blue box subsidies.

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Note: Numbers are based on each country’s WTO notifications in 2000, the last year for which data is available for all three countries. Amounts are in local currencies.
The tide of free trade will not float all boats

By Arvind Panagariya

Thanks to the advocacy of a few pressure groups and many international institutions, there is now a near-universal agreement that developed country subsidies and protection in agriculture hurt the poorest, least developed countries. This is a telling example of how political correctness can lead to the acceptance of an economically incorrect proposition.

The rich country subsidies and protection seriously distort the global trading system and must therefore be eliminated. But it is also true that, barring a few exceptional cases such as cotton, the least developed countries will actually be hurt by this liberalisation. The biggest beneficiaries of the rich country cuts in farm subsidies will be the rich countries themselves, which bear the bulk of the cost of the associated distortions, followed by the Group of 20 middle-income or larger developing countries led by Brazil, which will emerge as the main exporters of the liberalised products. Unless we recognise this fact, we shall fail to convert the Doha framework deal reached by the World Trade Organisation this weekend into a just final agreement for the poorest countries.

Current production and export subsidies flood world markets with the subsidised products and drive their prices down. The removal of these measures will raise the prices of the products in question. This will benefit the exporters and hurt the importers of these products. Food products happen to be among the most heavily subsidised items and as many as 45 of the world’s least developed countries are net food importers, according to calculations by the economists Alberto Valdes and Alex McCalla. Even when we consider all agricultural products, 33 least developed countries are net importers.

A counter-argument may be that, once the subsidies are eliminated and world prices increase, the least developed countries will become net exporters of the products. But this is doubtful for two reasons: such a change can turn at most only a handful of these countries into net exporters and the switch from net importer to net exporter status by itself is not enough to bring an overall benefit. As food prices rise, so will losses on food imports. Only if a country becomes a sufficiently large exporter will it be able to offset these losses.

Some may argue that, even if the least developed countries as a whole lose, their farmers will still benefit from the price increases. And in so far as the farmers are poor, the change will be for the better. But this is a treacherous argument: if the objective is to prevent farmers being undercut by cheaper imports, a countervailing duty against the subsidised imports, which is entirely legal under WTO rules, is a better instrument since it also generates revenues. But the decision by the countries not to impose this duty suggests that they prefer the lower prices for their consumers.

What about the net agricultural exporters? Surely they would benefit from liberalisation? Even here the story is more complicated. Protection keeps agricultural prices inside the European Union high. The Everything But Arms (EBA) initiative currently gives the least developed countries duty- and
quota-free access to the EU market for all products except rice, sugar and bananas. Poor country exporters can therefore benefit from the higher prices prevailing in the EU. Opening up the EU markets to all comers will lower EU internal prices and hurt the least developed country sellers as well as the EU sellers.

Another reason why exporters in the least developed countries may lose out from liberalisation is that less transparent regulatory policies, ostensibly for food hygiene and safety, may eventually replace more conventional barriers such as tariffs and quotas. The relatively richer G20 countries will be far better placed to overcome these barriers than the least developed countries. While this outcome is not a certainty, it is a strong possibility.

Why have the numerous studies of agricultural liberalisation failed to reveal these losses? There are three reasons. First, with rare exceptions, the studies simply ignore the fact that the EBA gives the least developed countries free access to the EU market. Second, some studies lump liberalisation by poor countries in with liberalisation by rich countries. In so far as the benefits to the least developed countries from their own liberalisation outweigh the losses inflicted on it by rich country liberalisation, the innocent reader is left believing that all liberalisation must be beneficial. Finally, some studies put the countries that lose into a broader region (for example, Bangladesh into South Asia) such that the gains to other countries in the region offset their losses.

The failure to recognise the adverse effects of trade liberalisation on poor countries poses two dangers as we move to the final stage of the Doha negotiations. First, without such recognition, we shall fail to design the compensation and adjustment programmes that such countries will need to adapt to liberalisation. Second, when the least developed countries, promised huge gains, find themselves badly damaged instead, they will be disillusioned about the benefits of trade. That could be fatal to the cause of future liberalisation.