

October 28, 2014

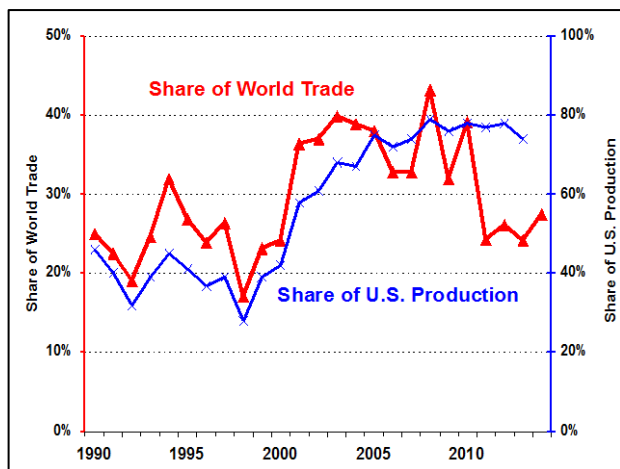
The WTO Brazil-U.S. Cotton Case

World Trade Organization (WTO) rules covering agricultural trade and domestic support programs for agriculture have played a large role in shaping current U.S. cotton policy. This paper summarizes cotton policy changes and how they came about in the so-called “WTO cotton case” brought by Brazil against U.S. cotton support programs.

U.S. Cotton Relies on Government Support and International Markets

The United States has historically been the world’s leading exporter of cotton, at times shipping nearly 80% of U.S. domestic production and supplying over 40% of the world’s cotton exports (Figure 1).

Figure 1. U.S. Cotton Exports as Share of U.S. Cotton Production and World Cotton Trade



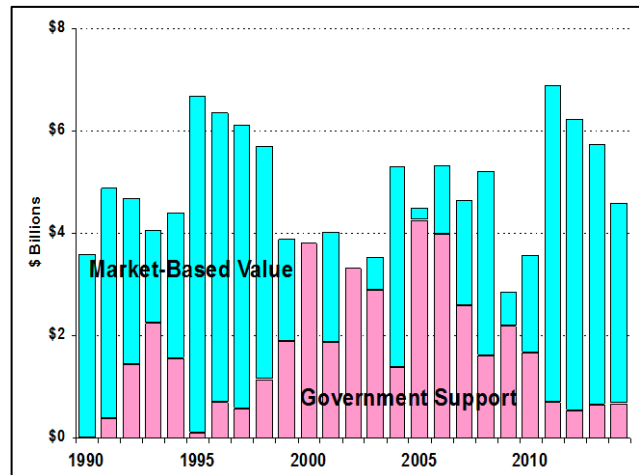
Source: USDA.

During periods of low market prices, U.S. cotton support programs have accounted for a large share of U.S. cotton receipts (Figure 2). In some years—especially between 1999 and 2010—federal program outlays nearly reached or exceeded the market value of the U.S. cotton crop.

U.S. Commitments in the WTO

As a signatory member of the WTO, the United States has committed to abide by WTO rules and disciplines—including those that govern domestic farm policy and its effects on international markets. In particular, according to the WTO’s Agreement on Subsidies and Countervailing Measures (SCM), a market-distorting program may be challenged when the program’s effect spills over into international markets—that is, if it can be established that a subsidy causes adverse market effects. For an SCM violation to be meaningful, another WTO member country must successfully challenge the violation under the WTO dispute settlement process.

Figure 2. Value of Annual U.S. Cotton Production

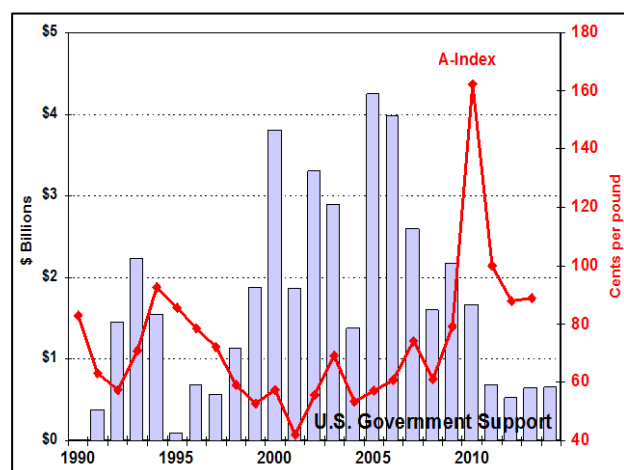


Source: USDA, crop year production values and fiscal year government-support data.

Brazil Challenges U.S. Cotton Programs

In 2002, Brazil—a major cotton export competitor—initiated a long-running WTO dispute settlement case (DS267) against U.S. cotton support programs. Brazil charged that U.S. cotton programs were depressing international cotton prices (Figure 3) and thus artificially and unfairly reducing the quantity and value of Brazil’s cotton exports, causing economic harm to its cotton sector.

Figure 3. U.S. Cotton Support versus International Cotton Prices



Source: USDA.

Note: The A-Index is a composite index of world cotton prices.

WTO Panel Rules in Brazil’s Favor

In September 2004, after a period of hearings and review, a WTO dispute settlement panel ruled in Brazil’s favor.

WTO Rulings in the Cotton Case

In 2004, a WTO panel found that U.S. agricultural programs were involved in two types of WTO violations.

Actionable Subsidies—cotton price and income support programs resulted in market distortions that depressed international cotton prices, as asserted by Brazil.

Prohibited Subsidies—certain U.S. agricultural export programs (including the GSM-102 program, which provides short-term export credit guarantees for certain U.S. agricultural products) were found to operate with implicit and illegal export subsidies under WTO rules.

The WTO panel ruled that if the violating policies were not withdrawn or altered according to specific timetables, then Brazil could take appropriate countermeasures (i.e., trade retaliation).

In December 2007, a WTO compliance panel ruled that U.S. policy changes to that point were inadequate, and the ruling was upheld on appeal in June 2008.

In 2009, a WTO arbitration panel ruled that Brazil's allowable retaliation could have two components:

- a fixed annual amount of \$147.3 million in response to the actionable subsidies, and
- a variable formula-derived amount based on annual U.S. GSM 102 program spending in response to the prohibited subsidies.

U.S. Modifies Farm and Trade Policy

As a result of the rulings and the potential for WTO-sanctioned retaliation, the United States made several successive policy changes in an attempt to bring the related programs into WTO compliance.

Because most farm programs are written in statute, they require congressional action to be changed. Such changes usually occur in the context of a new farm bill. However, the Administration also has some wiggle room in how it implements the farm programs. The successive policy changes evolved over several years and relied on both legislative action and administrative adjustments.

Changes Made Prior to the 2014 Farm Bill

In 2005 USDA added a risk-based fee to its export credit guarantee programs to eliminate the implicit export subsidy. In 2006, Congress eliminated the Step 2 cotton program—which made payment to exporters of U.S. upland cotton and which was found to operate as an illegal export subsidy—by a provision (§1103) in the Deficit Reduction Act of 2005 (P.L. 109-171). The 2008 farm bill (P.L. 110-246), made additional changes to the export credit programs, including the repeal of a fee cap on GSM 102 guarantees and the elimination of the GSM 103 (long-term 3- to 10-year credit guarantees) and Supplier Credit Guarantee programs.

Retaliation Avoided by Temporary MOU

In April 2010, just prior to the start of Brazil's threatened trade retaliation, the United States and Brazil agreed to a memorandum of understanding (MOU) that spelled out certain actions which, if taken by the United States, would

lead to a temporary suspension of the retaliation. These actions included, among others, monitoring U.S. use of export credit guarantees, pursuing joint discussions toward a final solution, and making an annual payment of \$147.3 million to a Brazil fund for certain authorized cotton-sector activities. The MOU was intended to be a bridge to the next U.S. farm bill, when permanent changes could be made.

The 2014 Farm Bill (P.L. 113-79)

The 2014 farm bill, signed into law in February 2014, authorizes current U.S. farm policy through 2018. Among traditional program crops, cotton was singled out for special treatment. Most previous farm safety net programs were repealed, with the exception of the marketing loan program and crop insurance. Unlike other crops, upland cotton was given a reduced marketing loan rate and was made ineligible for the new safety net programs available to traditional program crops. Instead, upland cotton producers are eligible for a stand-alone, county-based revenue insurance policy called the Stacked Income Protection Plan (STAX). Other WTO-related concessions included a reduced maximum term of 36 months for the GSM 102 program, and an allowance for certain additional uses of the U.S. funds paid to the Brazil cotton fund. In addition, USDA was given additional flexibility to negotiate with Brazil regarding the GSM 102 program.

A Final Resolution?

In early 2014 Brazil said it was still dissatisfied with U.S. policy changes, and appeared ready to request a new WTO compliance panel. Then, on October 2, 2014, Brazil and the United States appeared to reach an agreement resolving the long-running WTO dispute settlement case. The agreement included a final one-time U.S. payment of \$300 million to the Brazil cotton fund, and both a shortened term of 24 months and an additional fee component for the GSM 102 program. In return, Brazil agreed to drop the WTO cotton dispute and to abide by a temporary Peace Clause with respect to any new WTO actions against U.S. cotton support programs while the 2014 farm bill is in force, or against any agricultural export credit guarantees under the GSM 102 program as long as the program is operated in a manner consistent with the agreed terms.

The resolution to the cotton case could have an important bearing on how domestic support programs are treated in future WTO trade negotiations or in future dispute settlement cases. In addition to the implications for domestic support policy, the heightened attention surrounding the WTO Brazil-U.S. cotton case has set a precedent by singling out cotton for special treatment within ongoing WTO trade negotiations.

More Information

For more analysis, see CRS Report R43336, *Status of the WTO Brazil-U.S. Cotton Case*; CRS Report RS20840, *Agriculture in the WTO: Rules and Limits on Domestic Spending*; and CRS Report R43494, *Crop Insurance Provisions in the 2014 Farm Bill (P.L. 113-79)*.

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