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U.S.-Brazil WTO Cotton Subsidy Dispute

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Summary

The United States is the world's second-leading cotton producer and the world's leading cotton exporter. As a result, the U.S. cotton sector plays a highly visible role in international cotton markets. U.S. cotton exports and international market share have grown substantially over the past five years (1999-2003). During that same period, U.S. farm subsidies for cotton production expanded to an annual average of over \$2.7 billion per year.

In late 2002, Brazil requested consultation with the United States to discuss complaints about alleged effects of U.S. cotton program payments. The request — made under the auspices of the World Trade Organization (WTO) — initiated a dispute settlement process (case DS267) by Brazil against specific provisions of the U.S. cotton program, and set in motion a sequence of events designed to produce resolution of the dispute within a 12-15 month time frame. The eventual charges made against U.S. agricultural programs by Brazil in the documentation filed as part of the dispute settlement process are both far-reaching and comprehensive.

A WTO dispute settlement panel issued confidential interim and final reports on the dispute settlement case in April and June of 2004. The final report — made public on September 8, 2004 — confirmed panel findings against the United States on several key issues: first, U.S. domestic cotton subsidies have exceeded WTO commitments, thereby losing the protection afforded by the “Peace Clause” which shielded them from substantive challenges; second, the two major types of direct payments made under U.S. farm programs — Production Flexibility Contract payments of the 1996 Farm Act and the Direct Payments of the 2002 Farm Act — did not qualify for WTO exemptions from reduction commitments as fully decoupled income support and should therefore count against the “Peace Clause” limits; third, Step-2 program payments are prohibited export subsidies; fourth, U.S. export credit guarantees are effectively export subsidies, making them subject to previously notified export subsidy commitments; and fifth, U.S. domestic support measures have resulted in excess cotton production and exports that, in turn, have caused low international prices and have resulted in “serious prejudice” to Brazil.

The United States has announced that it will appeal the negative final rulings. Such an appeal would likely extend the dispute settlement process into 2005. Resolution of the WTO case in Brazil's favor could result in a WTO decision concerning implementation of U.S. program provisions for cotton, and possibly other major field crops.

This report provides background to the dispute, as well as the details of the ongoing WTO dispute settlement case. It will be updated as events warrant.

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U.S.-Brazil WTO Cotton Subsidy Dispute

Background on the U.S. Cotton Sector

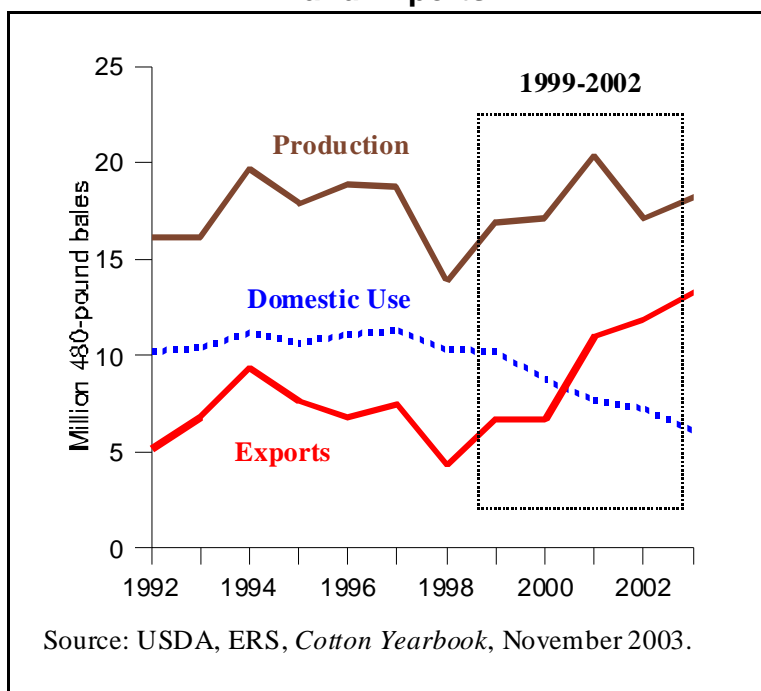
The cotton industry is a major component of the U.S. agricultural sector. From 1997 to 2002, U.S. cash receipts from cotton production averaged \$4.6 billion per year, while export sales averaged over \$2.1 billion. Cotton is grown across the southern tier of states stretching from Virginia down through the Carolinas and into Georgia, then westward through a belt of contiguous states stretching to California. Texas is the largest cotton-producing state, accounting for an average of 26% of U.S. production since 1993. In 2002, 17 states reported cotton production valued at over \$10 million.

Cotton is one of the principal U.S. program crops, along with wheat, rice, feed grains, soybeans, and peanuts. Qualifying U.S. cotton producers are eligible for direct payments, counter-cyclical payments, loan deficiency payments, Step-2 payments, and other program benefits.¹ From FY1991 to FY2004, U.S. farm subsidies for cotton production averaged \$1.7 billion per year. (See **Table 1**.)

The United States is the second-largest producer of cotton in the world. In recent years, the United States has been exporting an increasing share of its annual production, due in large part to a decline in domestic mill use. (See **Figure 1**.) U.S. exports as a share of production have averaged 59% since 2001, up from a 42% average during the early 1990s.

The United States is the world's largest cotton exporter. During the 2001-03 period, U.S. exports accounted for 40% of world trade, on average. Large U.S. subsidy levels coupled with U.S. prominence in global markets have directed much international attention to U.S. cotton program outlays in recent years.

¹ For more details on U.S. cotton program operations, see CRS Report RL32442, *Cotton Production and Support in the United States*, June 24, 2004.

Figure 1. U.S. Cotton Production, Use, and Exports**Table 1. U.S. Upland Cotton Program Outlays, Fiscal 1991-2004^a**

Fiscal year ^b	Total Outlays (\$ million) ^c
1991	382
1992	1,443
1993	2,239
1994	1,539
1995	99
1996	685
1997	561
1998	1,132
1999	1,882
2000	3,809
2001	1,868
2002	3,307
2003	2,889
2004 ^e	1,659
Average: 1991-2004	1,678

Source: USDA, Farm Service Agency, Budget Division, *History of Budgetary Expenditures of the Commodity Credit Corporation*, Books 3 (April 9, 2001) and 4 (July 15, 2003), available at [<http://www.fsa.usda.gov/dam/bud/bud1.htm>].

^a Data are for outlays within the reported fiscal year. Payments may be specific to cotton from several different crop or marketing years.

^b The fiscal year starts Oct. 1 and ends Sept. 30 of the following year. Fiscal year identification is with the second year. For example, FY1993 starts Oct. 1, 1992, and runs through Sept. 30, 1993.

^c Includes deficiency payments, production flexibility contract payments, loan deficiency payments, user market payments (Step 2), marketing loss payments, outlays from general loan operations, and other miscellaneous payments. Payments exclude loan repayment write-offs (otherwise referred to as producer marketing loan gains) and certificate sales proceeds/losses, both of which are treated as non-cash transactions.

^e USDA estimate, Table 35, “CCC Net Outlays by Commodity and Function,” July 30, 2004, available at [<http://www.fsa.usda.gov/dam/bud/bud1.htm>].

Arguments in the U.S.-Brazil WTO Cotton Case

In 2002, Brazil — a major cotton export competitor — expressed its growing concerns about U.S. cotton subsidies by initiating a WTO dispute settlement case (DS267) against certain features of the U.S. cotton program.² Once initiated, a dispute settlement case follows a sequence of events designed to produce resolution of the dispute within a 12-15 month time frame. (See **Table 3** for a timeline of the dispute settlement case.) Brazil’s case was broadly written and touched on almost every aspect of U.S. commodity programs, although focus has been on six principal claims (see below).³

On April 26, 2004, the WTO dispute settlement panel issued a confidential interim ruling on case DS267 to the two parties — Brazil and the United States. Although confidential, news reports suggested at least a partial finding against the United States on each of the five major claims.⁴ On June 18, 2004, the panel’s final ruling was released, again on a confidential basis, to Brazil and the United States. News reports suggested that the final ruling varied little from the interim ruling against the United States.⁵ The final ruling was issued publicly on September 8, 2004, after translation into English, French, and Portuguese.⁶

² *United States — Subsidies on Upland Cotton*, WT/DS267 (WTO Dispute Settlement Case 267). Documentation is available at [http://www.wto.org/english/tratop_e/dispu_e/dispu_e.htm].

³ Ministry of Foreign Affairs [Ministério das Relações Exteriores], Brasília; “Brazil-U.S.A. Dispute on Subsidies on Upland Cotton,” translation from the original in Portuguese, Nota nº 248-18/06/2004; Distribuição 22 e 23.

⁴ “Brazil Wins Key Points in Interim WTO Panel on U.S. Cotton Subsidies,” *Inside U.S. Trade*, April 30, 2004; “WTO Panel Backs Brazil in Complaint Against U.S. Over Cotton Subsidies,” *International Trade Reporter*, Vol. 21, No. 18, April 29, 2004; and “WTO Panel Reportedly Rules Direct Payments are Trade Distorting and Thus ‘Amber Box,’” AgWeb.com, April 30, 2004.

⁵ “WTO Ruling Against U.S. Cotton Subsidies is Not Limited to Cotton,” AgWeb.com, June 29, 2004; and “WTO Issues Final Ruling Condemning U.S. Cotton Subsidies; U.S. Plans Appeal,” *International Trade Reporter*, Vol. 21, No. 26, June 24, 2004.

⁶ *United States — Subsidies on Upland Cotton*, “Report of the Panel,” WTO, WT/DS267/R, Sept. 8, 2004; available at [http://www.wto.org/english/tratop_e/dispu_e/267r_a_e.pdf].

Each of Brazil's main claims is presented here along with the WTO dispute settlement panel finding.

Claim 1: Peace Clause Violation. Brazil claimed that the United States is no longer exempt from WTO dispute proceedings under the so-called "peace clause" (Article 13) of the WTO's Agreement on Agriculture (AA) because U.S. domestic and export subsidies to its cotton sector are in excess of its WTO commitments.⁷ Article 13 exempts domestic support measures that comply with the AA's requirements from being challenged as illegal subsidies through dispute settlement proceedings, as long as the level of support for a commodity remains at or below the benchmark 1992 marketing year (MY) levels. Brazil argues that U.S. cotton subsidies were about \$2 billion in MY1992 compared with over \$4 billion in MY2001.⁸ Therefore, Brazil argues that the United States is no longer in compliance with the requisite conditions and can no longer seek protection under the WTO's peace clause rule.

In response, U.S. trade officials argue that WTO members agreed to the peace clause recognizing that agricultural subsidies could not be eliminated immediately and needed, under certain conditions, to be exempted from the Subsidies and Countervailing Measures (SCM) Agreement and GATT 1994 subsidies disciplines. As a result, U.S. officials argue that the words "exempt from actions" as used in Article 13 of the AA are of overarching importance and preclude not only the "taking of legal steps to ... obtain a remedy," as Brazil has argued, but also the "taking of legal steps to establish a claim."⁹ Furthermore, U.S. trade officials argue that the immunity granted by the peace clause is still important, since even if a country is no longer in compliance with the peace clause, it is incumbent on the complaining party to prove there has been injury. (See "Claim 5," below.)

Finding 1. The panel found that Brazil had successfully discharged its burden to show that U.S. domestic cotton support measures exceeded WTO commitments during the 1992 marketing year. (See **Table 2.**) As a result, U.S. domestic cotton support measures lose the protection afforded by the "Peace Clause" which has shielded them from substantive challenges in the past. This occurs in part because, under Finding 2, PFC and DP outlays are re-classified by the WTO panel as "amber box" payments and evaluated against "peace clause" limits.

⁷ WTO, *The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations*, Cambridge Univ. Press, ©World Trade Organization 1999; hereafter referred to as *WTO Legal Texts*. Text of the Agreement on Agriculture is available online at [http://www.wto.org/english/docs_e/legal_e/14-ag.pdf].

⁸ USDA reports commodity program outlays on a fiscal year (FY) basis. (See **Table 1.**) However, marketing year data, not fiscal year, must be used in the WTO case. The U.S. cotton marketing year starts Aug. 1 and ends July 31 of the following year, but identifies with the first year, such that MY1992 starts Aug. 1, 1992, and ends July 31, 1993. The principal period in question, MY1999-MY2002, corresponds roughly with FY2000-FY2003.

⁹ *United States — Subsidies on Upland Cotton*, WT/DS267, "Initial Brief of the United States of America on the Question Posed by the Panel," June 13, 2003; available from the USTR website at [<http://www.ustr.gov/enforcement/briefs.shtml>].

Table 2. Comparison of Support in Accordance with Article 13(b)(ii)

\$ million	MY1992	MY1999	MY2000	MY2001	MY2002
Total	\$ 2,012.7	\$ 3,404.4	\$ 2,429.3	\$ 4,144.2	\$ 3,140.3

Source: *United States — Subsidies on Upland Cotton*, “Report of the Panel,” WTO, WT/DS267/R, Sept. 8, 2004; p. 157.

Claim 2: U.S. Direct Payments Do Not Qualify for Exemption from Reduction Commitments as Decoupled Income Support. Brazil claimed that two types of U.S. payments — Production Flexibility Contract (PFC) payments made under the 1996 farm bill and Direct Payments (DP) made under the 2002 farm bill — fail to fully meet the conditions for decoupled income support in Annex 2 of the Agreement on Agriculture and should be subject to WTO “amber box” limits.¹⁰

The United States considers both PFC and DP programs to be consistent with WTO language for exempt domestic support that has “no, or at most minimal, trade-distorting effects or effects on production.”¹¹ As a result, the United States notifies both the PFC and DP outlays as “green box” where they are not subject to any limits.

Finding 2. The panel found that U.S. payments made under the PFC and DP programs, because of the prohibition on planting fruits and vegetables on covered program acreage, do not qualify for the WTO’s green box category of domestic spending. (The green box contains only non-distorting program payments and is not subject to any limit). Instead, they should be counted as domestic subsidies directly affecting cotton production (i.e., distorting) and be notified as amber box payments. Amber box payments are subject to limitations agreed upon as part of each country’s WTO commitments.

Claim 3: The Step-2 Program Functions as an Export Subsidy. Brazil argued that Step-2 payments made under the U.S. cotton program function as export subsidies and are inconsistent with U.S. WTO obligations regarding export subsidies.

Step-2 payments are part of special cotton marketing provisions authorized under U.S. farm program legislation to keep U.S. upland cotton competitive on the world market. Step-2 payments are made to exporters and domestic mill users to compensate them for their purchase of higher priced U.S. upland cotton. Under the 2002 Farm Act, the Step-2 payment rate for the 2002-2005 marketing years is calculated as the difference between the price of U.S. upland cotton, delivered c.i.f.

¹⁰ Amber box programs are deemed trade and/or production distorting and, as such, are subject to limitations. For more information, see CRS Report RS21905, *The Agriculture Framework Agreement in the WTO Doha Round*.

¹¹ WTO, “Annex 2 — Domestic Support: The Basis for Exemption from the Reduction Commitments,” *WTO Legal Texts*, p. 48.

(cost, insurance, freight) in Northern Europe and the average of the five lowest prices of upland cotton delivered c.i.f. Northern Europe from any source.¹²

The United States argued that Step-2 payments are part of its domestic support program since they are targeted to domestic cotton users as well as exporters. As a result, Step-2 payments are notified to the WTO as “amber” box (trade-distorting) domestic support payments and not as export subsidies. Consequently, U.S. trade officials contend that Step-2 payments are not subject to any limitations placed on export subsidies.

Finding 3. In its finding, the panel considered Step-2 program payments to eligible exporters separately from payments to domestic users.

- Payments to exporters were found to be “contingent upon export performance” and therefore qualified as prohibited export subsidies in violation of WTO commitments.
- Payments to domestic users contingent on the use of domestic over imported goods were found to be prohibited import substitution subsidies.

Claim 4: U.S. Export Credit Guarantees Function as Export Subsidies. Brazil claimed that the favorable terms (i.e., the interest rate and time period that countries have to pay back the financing) provided under U.S. export credit guarantee programs — GSM102, GSM103, and the Supplier Credit Guarantee Program (SCGP)¹³ — are effectively export subsidies inconsistent with the WTO’s AA and SCM. Further, the subsidy effects of export credit guarantees apply not only to cotton, but to other eligible commodities.¹⁴

U.S. trade officials argued that the U.S. export credit guarantee programs are consistent with WTO obligations. Furthermore, the United States asserted that Article 10.2 of the AA reflected the deferral of disciplines on export credit guarantee programs contemplated by WTO members.

Finding 4. The panel found that U.S. export credit guarantees were effective export subsidies because the financial benefits returned by these programs failed to

¹² Only prices for Middling (M) 1-3/32-inch upland cotton are used in the calculation. Also, certain price triggers must be met and held for a specified period of time before payments can be made. For information on the Step-2 program and other U.S. cotton program features, see USDA, ERS, “Cotton Briefing Room,” at [<http://www.ers.usda.gov/Briefing/Cotton/>].

¹³ For information on U.S. export credit programs, see USDA, Foreign Agricultural Service (FAS), “Export Credit Guarantee Programs,” at [<http://www.fas.usda.gov/excredits/default.htm>]. For information on MAP, see USDA, FAS, “Export Programs — Market Access Program (MAP),” at [<http://www.fas.usda.gov/export.html>].

¹⁴ For a list of commodities eligible for export credit guarantees see USDA, Foreign Agricultural Service, *USDA Amends Commodity Eligibility under Credit Guarantee Programs*, News Release, Sept. 24, 2002; available at [http://www.fas.usda.gov/scripts/PressRelease/pressrel_dout.asp?Entry=valid&PrNum=0346-02].

cover their long-run operating cost.¹⁵ Furthermore, the panel found that this applies, not just to cotton, but to all commodities that benefit from U.S. commodity support programs and receive export credit guarantees. As a result, export credit guarantees for any recipient commodity are subject to previously scheduled export subsidy commitments for that commodity. This refers to those U.S. export subsidies under the Export Enhancement Program (EEP).¹⁶ Under these criteria, export credit guarantees benefits extended to cotton and other “unscheduled” commodities (that are supported under U.S. agricultural programs) are found to be in violation of previous WTO commitments. With respect to “scheduled” commodities, export credit guarantees extended to U.S. rice exports were found to be in violation of previous EEP volume commitments.

The panel found that “unscheduled” commodities not supported under U.S. agricultural programs, as well as scheduled agricultural products that remain within WTO commitments are exempt from actions under this dispute settlement case.

Claim 5: U.S. Subsidies Have Caused “Serious Prejudice”. Brazil argued that the subsidies provided to U.S. cotton growers contributed to significant overproduction and resulted in a surge in U.S. cotton exports, particularly during the 1999-2002 marketing years, when unusually large outlays were made under provisions of the U.S. cotton program (see **Table 1** and **Figure 1**). Brazil claimed that the resultant rise in U.S. exports led to three market conditions, each of which contributed to serious injury to Brazilian cotton exporters: (i) by increasing the U.S. share of the world upland cotton market; (ii) by displacing or impeding Brazilian upland cotton sales in third-country markets; and (iii) by contributing to a steep decline in world cotton prices (see **Figure 2**).¹⁷ In particular, Brazil claims that injury to its economy due to low cotton prices, measured as the sum of individual negative impacts on income, foreign trade revenue, fiscal revenues, related services (transportation and ginning), and employment, exceeded \$600 million in 2001 alone. Brazil asserts that injury under each of these three circumstances are in violation of

¹⁵ Found to violate Annex I(j) of the SCM, *WTO Legal Texts*, p. 267, which identifies as an export subsidy, “The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.”

¹⁶ The United States has scheduled export subsidy reduction commitments for the following thirteen commodities: wheat, coarse grains, rice, vegetable oils, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, pigmeat, poultry meat, live dairy cattle, and eggs. For more information on the EEP program and U.S. export subsidy commitments see CRS Report RS20399, *Agricultural Export Programs: The Export Enhancement Program (EEP)*. See also *Export Enhancement Program*, Foreign Agricultural Service, USDA at [<http://www.fas.usda.gov/excredits/eep.html>].

¹⁷ Articles 5(c) and 6.3(b) of the Agreement on Subsidies and Countervailing Measures (SCM) deal with subsidies that result in adverse effects in other WTO-member countries. Brazil specifically identified Argentina, Bangladesh, Colombia, Germany, India, Indonesia, Italy, Portugal, Philippines, Slovenia, South Africa, South Korea, Switzerland, Thailand, and Turkey as the relevant third-country markets. WTO “Communication from Brazil,” WT/DS267/9, March 21, 2003.

the Agreement on Subsidies and Countervailing Measures (SCM).¹⁸ In addition, Brazil argued that these same programs would be harmful (i.e., threatened serious prejudice) in future years.

U.S. trade officials argue that the subsidies provided to U.S. cotton growers have been within the allowable WTO limits and are consistent with U.S. WTO obligations. Furthermore, they argue that the decline in U.S. domestic use (due to declining U.S. competitiveness in textile and apparel production), rather than government support program outlays, has contributed to larger U.S. raw cotton exports. In addition, they contend that international market forces — including weakness in world demand for cotton due to competing, low-priced synthetic fibers, and weak world economic growth — have played a larger role in determining the generally weak price level during the period in question, rather than U.S. export levels. For example, see **Figure 3** for a visibly strong correlation between China cotton imports and the international cotton “A-index.”

In evaluating this particular claim, the panel separated U.S. cotton support programs into two groups: those that are directly contingent on market price levels (marketing loan gains, loan deficiency payments, counter-cyclical payments, and Step-2 payments), and those that are not (PFC and Direct Payments, and the federal crop insurance program).

Finding 5. The panel found that U.S. domestic support measures that are directly contingent on market price levels caused serious prejudice in terms of market price suppression for the period 1999 to 2002. However, U.S. domestic support measures that are not contingent on market price levels were not included in this finding. The panel also did not find in favor of Brazil’s alleged serious prejudice in terms of an effect on international market share. Article 6.3 of the SCM lists several factors indicating serious prejudice; the panel only had to find one of the factors in violation to rule in Brazil’s favor on the claim of serious prejudice during the 1999 to 2002 period.

With respect to Brazil’s claim of a threat of serious prejudice going forward (i.e., 2003 to 2007 — the remaining life of the 2002 farm act), the panel stated in its final report that those “prohibited” subsidies that cause the serious prejudice during the 1999-to-2002 period — namely, user marketing (Step-2) payments to exporters and domestic users; and export credit guarantees in respect of certain products under the GSM 102, GSM 103, and SCGP programs — must be withdrawn “without delay” pursuant to Article 4.7 of the SCM Agreement.¹⁹ According to the panel, required withdrawal of the prohibited subsidies, within the time frame set by the panel, would curtail the threat posed by U.S. cotton support programs. As a result, the panel stated

¹⁸ Text of the Agreement on SCM is available online at [http://www.wto.org/english/docs_e/legal_e/24-scm.pdf].

¹⁹ *Report of the Panel*, “United States — Subsidies on Upland Cotton,” WTO, WT/DS267/R, Sept. 8, 2004, p. 345.

that “...it is not necessary or appropriate to address Brazil’s claims of threat of serious prejudice...”²⁰

Claim 6: FSC-ETI Act of 2000 Acts as an Export Subsidy to Upland Cotton. Brazil contends that the Foreign Sales Corporation Repeal and Extraterritorial Income Act of 2000 (ETI Act of 2000), by eliminating tax liabilities for U.S. upland cotton exporters who sell to foreign markets, constitutes an export subsidy and is inconsistent with U.S. export subsidy commitments for cotton.

The United States asserted throughout the proceedings that Brazil has failed to make any specific case with respect to the ETI Act of 2000 and U.S. upland cotton exports.

Finding 6. The panel concurred with the United States in stating that Brazil failed to present any new arguments or evidence concerning effects upon upland cotton, but instead simply repeated the arguments that the European Union made in its WTO dispute settlement case with the United States (DS108).²¹ As a result, the panel declined to further examine Brazil’s claims on this particular issue.

²⁰ Ibid.

²¹ For more information, see CRS Report RL32014, *WTO Dispute Settlement: Status of U.S. Compliance in Pending Cases*.

Figure 2. U.S. Cotton Exports and International Cotton Price Index

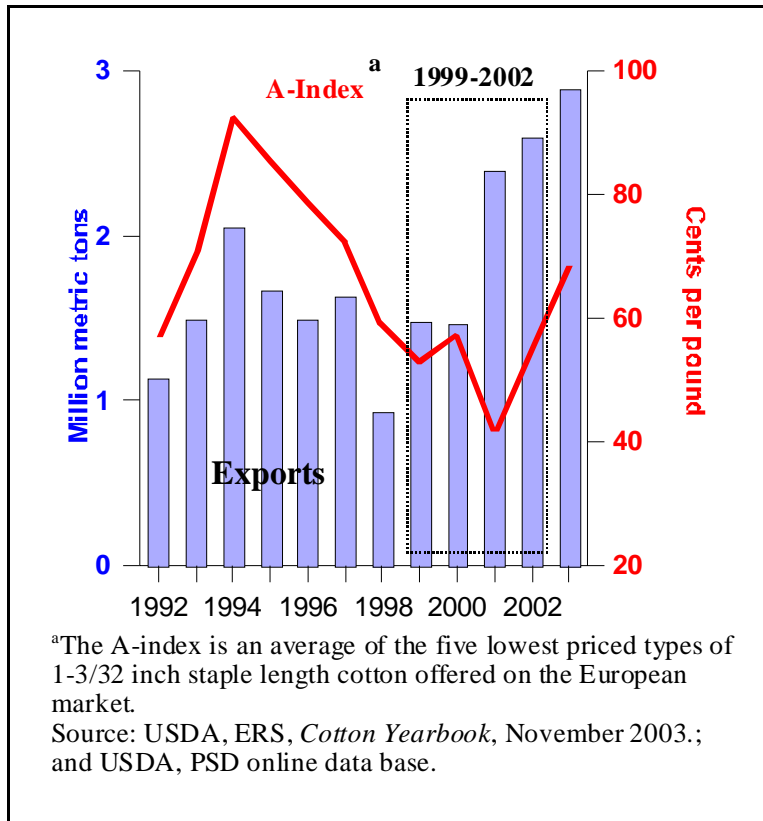
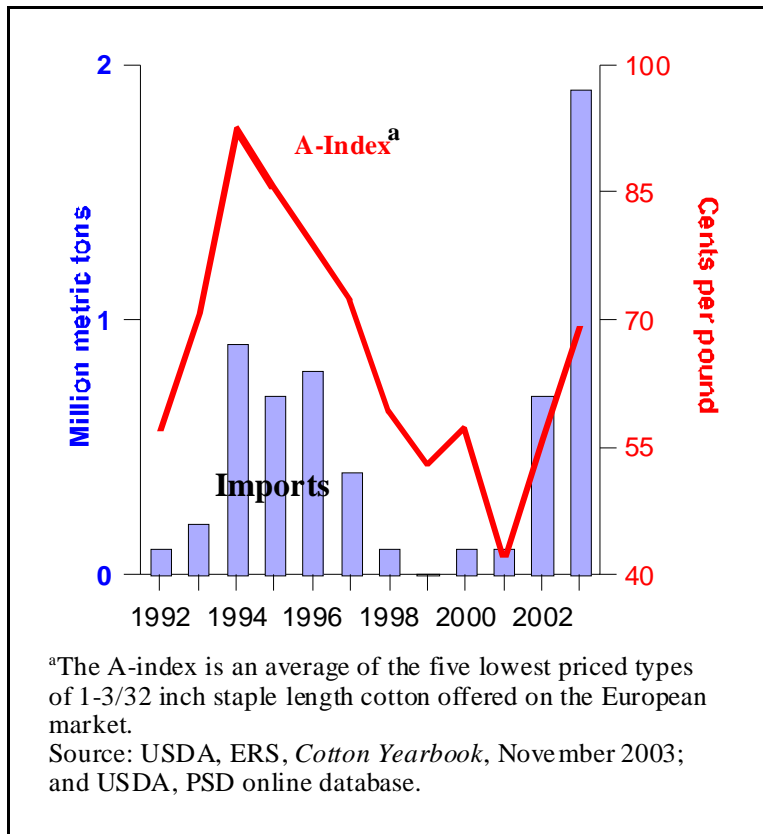


Figure 3. China Cotton Imports and International Cotton Price Index



Panel Recommendations

In its final report, the panel recommends that the United States withdraw those support programs identified as prohibited subsidies within six months of the date of adoption of the panel report by the Dispute Settlement Body or by July 1, 2005 (whichever is earlier). The list of prohibited subsidies subject to withdrawal “without delay” includes:

Prohibited export subsidies:

- export credit guarantees under GSM 102, GSM 103, and SCGP that assist exports of upland cotton and other unscheduled agricultural products that are supported under government agricultural support programs; and
- Step-2 program payments to exporters of upland cotton.

Prohibited import substitution subsidy:

- Step-2 payments to domestic users of upland cotton.

The panel also issued recommendations concerning the “actionable” subsidies identified as contributing to serious prejudice to the interests of Brazil. Specifically, this involves those U.S. subsidy measures singled out as price-contingent — marketing loan provisions, Step-2 payments, and CCP payments. The panel recommends that, upon adoption of its final report, the United States take appropriate steps to remove the adverse effects or to withdraw the subsidies.

Potential Implications of WTO Panel Ruling

Trade experts have expressed concern that the panel findings could extend beyond cotton to other major field crops, not only for the potential limits on export credit guarantees, but also with respect to the reclassification of PFC and Direct Payments from non-trade-distorting green box support to the trade-distorting amber box.²² During FY2000 to FY2003, PFC and Direct Payments averaged nearly \$5 billion per year and accounted for 32% of total U.S. agricultural program outlays. Shifting this amount to amber box could have important implications for future dispute settlement cases, as well as for the United States’ ability to meet its WTO amber box commitments. As a result, some market analysts have expressed concern that a broad finding against the U.S. cotton program, as well as other general commodity programs such as direct payments and export credit guarantees, could necessitate legislative changes to bring existing program operations into compliance; and that such potential program changes could necessitate that the U.S. farm bill be reopened well before its scheduled expiration in 2007.

In public testimony to the House Agriculture Committee on April 28, 2004, U.S. Trade Representative (USTR) Robert Zoellick stated that U.S. farm programs are

²² “Brazil Wins Key Points in Interim WTO Panel on U.S. Cotton Subsidies,” *Inside U.S. Trade*, April 30, 2004.

fully consistent with WTO rules.²³ In addition, Zoellick added that “the United States has been willing to negotiate its subsidies and willing to negotiate its tariffs.... [I]t would be a very big mistake to try to solve these very complex agricultural issues through the process of litigation.”²⁴ Following the release of the panel’s final report on September 8, 2004, Ambassador Zoellick stated that the United States intends to appeal aspects of the panel’s final report.²⁵ Zoellick also stressed to the committee that the ruling would have “no immediate impact for farmers and ranchers” since the WTO process, including an appeal, would last months or possibly years.

In public testimony to the House Committee on Agriculture on May 19, 2004, Woody Anderson, chairman of the National Cotton Council (NCC), stated that, although the U.S. cotton industry had not been allowed to see the confidential interim report, the NCC “will fight this decision and its ramifications ... but we will also work to ensure that the U.S. cotton program complies with WTO disciplines.”²⁶

What’s Next? Once the final report was issued to the WTO Dispute Settlement Body (DSB) on September 8, 2004, the clock started ticking on a series of sequential events.

Within 20 to 60 days of its release, the report will be adopted by the DSB unless all members, including the party initiating the dispute (i.e., Brazil), vote not to do so (“reverse consensus rule”) or if a party to the dispute formally notifies the DSB of its decision to appeal. If appealed, the panel report will not be considered for adoption by the DSB until after the appellate report is issued.²⁷

Either side can appeal a panel’s ruling, although appeals have to be based on points of law and legal interpretation — they cannot reexamine existing evidence or examine new evidence. In a September 8, 2004, press conference, USTR agricultural negotiator Allen Johnson stated that the United States plans to appeal the WTO cotton subsidies decision, but that USTR is reviewing “very thoroughly” how it will proceed. The United States must notify its appeal no later than 60 days from September 8.

Once appealed, the case would be submitted to the WTO’s standing Appellate Body (AB) for review. Each appeal is heard by three members of a permanent seven-member AB set up by the Dispute Settlement Body (DSB). Under an appeal,

²³ Statement of USTR Robert B. Zoellick, before the Committee on Agriculture, U.S. House of Representatives, April 28, 2004; available at [<http://agriculture.house.gov/hearings/108/10829.pdf>].

²⁴ Ibid.

²⁵ *WTO Panel Issues Mixed Verdict in Cotton Case*, USTR Press Release, Sept. 8, 2004; available at [<http://www.ustr.gov/>].

²⁶ Statement of Woody Anderson, chairman, National Cotton Council, before the Committee on Agriculture, U.S. House of Representatives, May 19, 2004; available at [<http://agriculture.house.gov/hearings/108/10829.pdf>].

²⁷ “Understanding on Rules and Procedures Governing the Settlement of Disputes,” Article 16 (4), Adoption of Panel Reports, *WTO Legal Texts*, p. 365.

the AB would review the case, then issue a report to the DSB. The AB must issue its report 60 days after notification of appeal; however, this is extendable to 90 days. Requisite translation of the report (into English, French, and Portuguese) increases the likelihood of extension to the full 90 days. The DSB would then adopt the report under the reverse consensus rule. The entire process from the release of the dispute settlement panel's final report through the appeal process could potentially take several months.

If the report adopted by the DSB (whether the panel's final report alone, or the Appellate Body report and the panel report with any modifications by the Appellate Body) decides that the disputed measures do violate a WTO agreement or obligation, the report will recommend that the measures be made to conform with WTO rules. The dispute settlement panel may suggest how this is to be done.

Within 30 days after the report or reports are adopted, the United States would be expected to present an implementation plan to the DSB. If complying with the recommendation immediately is impracticable, a compliance period will be established. If the United States fails to comply by the end of this period, Brazil could request negotiations with the United States to determine mutually acceptable compensation (e.g., tariff reductions in areas of particular interest). If the two sides are unable to agree on compensation, Brazil may ask the DSB for permission to impose limited trade sanctions against the United States.

Other Cotton-Related Trade Issues

Besides Brazil's WTO-initiated dispute settlement case (DS267), U.S. cotton subsidies are being challenged at the WTO on two additional fronts.

- First, the Doha Development Agenda negotiating round has substantial reductions in trade-distorting domestic program support as one of its principal modalities.²⁸ If realized, a new round of domestic spending limitations could potentially represent a "real" ceiling on U.S. commodity spending and could result in lower program outlays.
- Second, a consortium of four African cotton-producing countries — Benin, Burkina Faso, Chad, and Mali — has submitted a WTO proposal calling for a global agreement to end all production-related support for cotton growers of all WTO-member cotton producing nations.²⁹ In acknowledgment of the concerns of African cotton-producing countries, the United States — while not agreeing with the African proposal — worked with the African countries on a formulation in the recently completed agriculture framework (July

²⁸ WTO, Doha Ministerial Declaration, WT/MIN(01)/DEC/1, Nov. 20, 2001.

²⁹ For more information, see CRS Report RS21712, *The African Cotton Initiative and WTO Agriculture Negotiations*.

31, 2004) of the WTO's ongoing Doha Round.³⁰ Although no specific cotton program concessions were mentioned in the framework, the United States committed "to achieve ambitious results expeditiously" under the framework. Further, it is notable that cotton is the only commodity singled out for special mention in the framework.

Role of Congress

Given the importance of cotton in the U.S. agricultural economy and the potential for WTO-imposed limitations on U.S. cotton program operations, Congress likely will be closely monitoring developments in the U.S.-Brazil cotton dispute. Since the confidential release of the WTO dispute settlement panel's interim report, the House Committee on Agriculture has already held two hearings (April 28 and May 19, 2004) on agricultural trade negotiations.³¹ Among the trade issues discussed during these hearings, both U.S. Trade Representative Zoellick and Woody Anderson, chairman of the National Cotton Council, provided testimony on and responded to questions regarding the U.S.-Brazil WTO cotton case.

In his testimony to the House Committee on Agriculture, May 19, 2004, Mr. Anderson expressed his support for the WTO negotiations stating that "[a] rational, rules-based international trading system is superior to the alternative. We will do our part, working with this committee and the administration, to maintain an effective U.S. cotton program that complies with WTO rules."³² However, he also expressed his concern that U.S. programs such as the export credit guarantees and decoupled direct payments — programs that he felt were clearly exempted from reduction commitments under the Uruguay Round Agreement — might fail to withstand challenges under the WTO dispute settlement process.

In addition to congressional hearings, under fast track or Trade Promotion Authority (TPA) legislation, Congress will be engaged in consultations with the Administration on negotiations of the Free Trade Agreement for the Americas (FTAA) and the agriculture negotiations in the WTO. Such consultations will be a major vehicle for Members to express their views on this dispute and on the negotiating issues it raises.

Ultimately Congress is responsible for passing farm program legislation that complies with U.S. commitments in international trade agreements. With respect to the potential acceptability of a new trade agreement under the ongoing Doha Round, Mr. Anderson stated that the cotton case at the WTO "should raise a caution flag for

³⁰ For more information, see CRS Report RS21905, *The Agriculture Framework Agreement in the WTO Doha Round*.

³¹ House of Representatives, 108th Congress, Committee on Agriculture, *Agricultural Trade Negotiations*, Serial No. 108-29; available at [<http://agriculture.house.gov/hearings/108/10829.pdf>].

³² Statement of Woody Anderson, chairman, National Cotton Council, before the Committee on Agriculture, U.S. House of Representatives, May 19, 2004; available at [<http://agriculture.house.gov/hearings/108/10829.pdf>].

this Congress, for our current negotiators, and for the private sector.... The job of drafting an agreement that should pass muster in the U.S. Congress just got a lot more difficult.”³³

Table 3. Timeline: U.S.-Brazil WTO Dispute Settlement Case 267

Date	Event
Sept. 27, 2002	Brazil made a formal “request for consultations” with the United States.
Oct. 2002 to Jan. 2003	Brazil and the United States held three consultations to discuss the dispute over U.S. cotton subsidies. The consultations were unsuccessful.
Feb. 7, 2003	Brazil’s first request for the establishment of a dispute panel to rule on its complaint is vetoed by the United States.
Mar. 18, 2003	Upon Brazil’s second request, the WTO’s Dispute Settlement Body (DSB) established a panel at its meeting on March 18, 2003.
May 19, 2003	Appointment of the panelists by the WTO Director-General. Once formed, a panel normally has six months to hold hearings and gather testimony before issuing its final report to both parties.
July 22-24, 2003	First meeting with the DSB panel. The panel decides to review the peace clause issue and Brazil’s challenge to U.S. cotton subsidies separately.
Sept. 2003	The panel reversed an earlier procedural decision and stated that it would decide both the peace clause issue and Brazil’s challenge to U.S. cotton subsidies together.
Nov. 17, 2003	The panel chairman informed the DSB that the panel would not be able to complete its work in six months due to the complexity of the matter. An extension was announced.
April 26, 2004	The panel’s interim report is released confidentially to the two parties. Both parties will review the Interim Report and submit written comments by May 10, at which time they will have an additional three weeks to review each other’s comments and respond.
June 18, 2004	The panel’s final report is released confidentially to the two parties.
Sept. 8, 2004	The translated final report is delivered to the WTO Dispute Settlement Body (DSB) — all Members.
30 days after release of final report	Where a panel finds that a prohibited subsidy or injurious domestic subsidy exists, the SCM Agreement requires that the report be adopted by the DSB under the reverse consensus rule within 30 days after circulation unless appealed.
Appeal notification	The United States must formally announce its intention to appeal after release of the final report but prior to its adoption by the DSB.

³³ Ibid.