
COTTON UPDATE – 17 September 2009

Brazil–US dispute over cotton: Salomon’s decision?

The panel’s rulings¹

The arbitration panel for the dispute between Brazil and the United States over upland cotton subsidies and export guarantee subsidies submitted its conclusions on 31 August concerning the amount of retaliation Brazil is authorized to take in the case. There is no appeal from an arbitration panel ruling. Now, the ruling is final and the US can no longer appeal. As the subsidies in dispute had already deemed illegal, the arbitration panel limited itself to three questions: (i) the amount of retaliation related to the prejudice finding; (ii) the amount of retaliation authorized because of the prohibited subsidy finding; and (iii) the form that such sanctions could take (i.e. authorization for cross-retaliation).

1. Amount of retaliation

The panel issued two separate decisions. Regarding cotton subsidies, the panel authorized sanctions of USD 147 million annually based on its calculation of cotton price impacts in 2005. The second decision approved a methodology the calculation of the annual amount of sanctions related to the export credit guarantee program based on current transactional values of agricultural exports under that program. Using transactional values US in 2006 as a benchmark, the panel ruled that Brazil could retaliate up to USD 147 million for the prohibited subsidies. It should be borne in mind that Brazil had requested USD 2.5 billion of economic retaliation² for both aspects of the case. The US, on the other hand, insisted that the maximum amount of retaliation should be fixed at no more than USD 23 million per year. The US was pleased at the panel’s ruling because the amount awarded was far below the

¹ For the WTO texts, see http://www.wto.org/english/tratop_e/dispu_e/267arb_part1_e.pdf and http://www.wto.org/english/tratop_e/dispu_e/267arb_part2_e.pdf.

² The amount of \$2.5 billion includes :

(i) USD 1,155 million with respect to the export credit guarantees (see, for instance, paragraph 92 of the submission) + (ii) USD 350 million (“one-off”, not annual) related to Step 2 (see, e.g., paragraph 249) + (iii) USD 1,037 million in respect of actionable subsidies (see, for instance, paragraph 447). This makes a total of USD 2,542 million, or approximately USD 2.5 billion (and 2.2 if the one-off step 2 amount is subtracted).

amount of countermeasures Brazil had requested. Brazil was also satisfied because the amount was the second-largest retaliation amount ever awarded by an arbitrator and because Brazil estimates the calculation methodology would authorize retaliation up to some USD 800 million³ if applied to the year 2009.

The ruling is indeed a Salomon's decision, for two reasons: it provides a restrictive reading of prejudice compared to Brazil's request but the amounts are significant and the prejudice is clearly recognized and confirmed. The question which then arises is determining whether the amounts are enough of a deterrent to persuade the US to reform its cotton support regime. Although they may not suffice, everything will depend to a large extent on how Brazil will use this authorization to sanction the United States. The export credit guarantee award could pose much more of a dilemma for the United States than the cotton award.

2. Cross-retaliation

To a certain extent, the principle that sanctions must be imposed in the field where the prejudice occurred (in this case agricultural and non-agricultural goods) was respected and remains the rule. Any exception to the rule has to be based on proof of the needs. Brazil was requesting authorization to impose sanctions in the fields of services and intellectual property. Here as well, the panel's ruling is a Salomon's decision because even though the principle is respected – sanctions will be applied to goods –, a country like Brazil has also been granted an exemption hitherto “reserved” for small, relatively undeveloped countries⁴. Brazil can exercise the right of cross-retaliation if the total authorized retaliation (serious prejudice + prohibited subsidies) exceeds an amount calculated based on the level of total Brazilian imports of US goods⁵. The Americans say that they are also pleased by the restriction on cross-retaliation, as they feel that the amounts mentioned will not be reached. Brazil hailed the ruling, as this right has only been granted once in the history of dispute settlement. Moreover, cross-retaliation allows developing countries to exercise fully their right to compensation without jeopardizing their own trade with the non-compliant country insofar as the cost of switching to non-US suppliers would outweigh the benefits from sanctions.

As Brazil sees it

³ As mentioned in the press release provided by the Brazilian mission to the WTO on the 31st of August. See also “USTR Under Pressure To Bring Cotton Compliance Panel After Ruling”, *Inside US Trade*, 4th September 2009

⁴ See the case of Antigua and Barbuda

⁵ According to the formula proposed by the arbitrary panel, the threshold relates to the amounts of US goods imported by Brazil. For the year 2009, Brazil estimates that the threshold should be reached and would allow Brazil to cross-retaliate. According to the press release provided by the Brazilian mission to the WTO on the 31st of August, counter-measures for 2009 could amount to \$ 800 million. First calculations show that Brazil could impose countermeasures on goods up to \$ 460 million and \$ 340 million in countermeasures targeting Services and IP.

As far as Brazil is concerned, this ruling will largely shape its future strategy. It could use the ruling in one of three ways:

- To immediately implement a package of specific political and economic measures aimed at persuading the US to change its cotton support policy and to end its export credit guarantee program;
- Within the framework of its relations and bilateral negotiations with the United States;
- By preparing a series of measures and by threatening to apply them in order to force the Americans to move ahead in the Doha negotiations.

At present, no one knows which option Brazil will choose. According to Brazilian Ambassador Azevedo in Geneva, Brazil will analyze “in due time” how to exercise this right to retaliation, both for the amounts and in fields other than goods.

As the US sees it

There have been many reactions to the panel’s ruling in the United States. Senator Tom Harkin, Chair of the Agriculture Committee, recognizes that “the ruling is final and we now have to live with it”, while his colleague Saxby Chambliss deems it premature to consider a change in support levels. Representative Charles Grassley stated that the ruling means that “agricultural programs must be WTO-compliant”. The National Cotton Council continues to dispute a judicial decision and dodges the issue by stating that given the sharp drop in US production (which, granted, has fallen off by nearly 45%), the negative ruling does not reflect the facts on the ground. In addition, the NCC argues that the real problem is countries like China and India, which have stepped up their cotton production and are said to rely heavily on subsidies. Some associations, such as the American Farm Bureau Federation, challenge the ruling – even though it is now final –, continue to deny that the US has failed to comply with WTO rules and have even joined other organizations like the NCC in requesting a new compliance panel that would take relevant changes in US legislation into account.

In any event, now that the US has become a tireless promoter of compliance with WTO rules when it comes to cases won, especially against China, the panel’s outcome cannot remain a dead letter, with regard to both cotton itself and in view of the cross-retaliation which is now a possibility, as well as in the broader context of the Doha negotiations.

As the C4 sees it

While favoring a negotiated solution, the C4 countries have always backed Brazil’s legal action against the US. They can be delighted that a number of US subsidies have indeed been ruled illegal because they cause severe injury to non-American cotton producers. As far as they are concerned, this is a moral victory. The point should be made, however, that even though some C4 countries have filed a third party objection in the proceedings, they

themselves are not entitled to exercise trade retaliation against the US (moreover, this would, technically speaking, be very difficult to implement insofar as they have nothing, or virtually nothing, apart from cotton). Making US legislation compliant with WTO rules would facilitate the enforcement of existing rules (those decided during the Uruguay Round) and would be a first step in the right direction. That having been said, the C4 continue to press for a change in future rules, in accordance with the Hong Kong mandate. For all members applying trade distorting subsidies, this implies disciplines over and above the ones which the US faces in a dispute settlement context. A solution within the Doha framework remains the goal as far as the C4 countries are concerned. Clearly, this ruling will step up the pressure on the US with regard to multilateral negotiations. As emphasized in the “Washington Insider” section of the DTN on 2 September, “US reaction to this case obviously weakens its ability to exercise effective leadership in the Doha Round effort to reduce trade barriers, a development that is bad news for the revitalization and completion of the Round which is now being discussed and for US meats and other high-value exports which still face significant tariffs”. If the sanctions which Brazil is entitled to impose do not lead the US to change policy, the C4 will be obliged to consider the relevance of bringing its own complaint against the US, a question that deserves a very close look when the time comes.

From the standpoint of the multilateral trade system

The credibility of the multilateral trade system hinges on compliance with dispute settlement rulings. And even though the WTO arbitrators have not made things easier by avoiding a clear-cut ruling, compliance remains essential, both for the good of the institution and for the trust that its members, especially the least developed countries, have placed in the system. “Having international rules is very important because if you want to move ahead in trade and market your products abroad, knowing the rules of the game builds trust and enhances export opportunities”, stated... Charles Grassley himself.

Conclusion

As can be seen from the reactions of the parties to the dispute, the panel’s ruling can be seen as a half-empty or a half-full glass. Regardless of one’s position, it is clear that the system has worked. This ruling further encourages the US to rethink its cotton support policy. According to Senator Harkin, “it would have been preferable to settle these trade disputes in through careful negotiations rather than through WTO litigation and it is unfortunate that the matter has had to come to this point”. This is an encouraging or at least a pleasant stand for a country that is long overdue in delivering a cotton counterproposal! Naturally, Brazil and the C4 countries are more than willing to negotiate such a long-awaited solution...

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