
COTTON UPDATE – 9 April 2010

US-Brazil Cotton Case Deal of the 5th of April: What does it mean for Brazil, the US, the multilateral trading system and the African countries.

Short background

On Monday the 5th of April 2010, Brazil and the United States exchanged letters in which the US – for the first time – agreed to enter into concrete negotiations to settle the long standing dispute with Brazil on US cotton subsidies on the basis of which Brazil agreed to postpone the implementation of countermeasures which were supposed to enter into force the same week.

The US Brazil cotton dispute – initiated in 2002 – has led to the condemnation of the US subsidies to its cotton farmers, decision confirmed by the Appellate Body of the WTO in 2005 and 2008. In 2009, the WTO Dispute Settlement Mechanism authorized Brazil to take retaliatory measures against the US in the field of goods as well as - under certain conditions – cross retaliations in the services sector and in Intellectual Property Rights.

Despite numerous consultations between the US and Brazil, no progress had been made in finding a solution to the cotton dispute as the US refused to enter into any meaningful negotiations asserting that any solution had to be approved by Congress which was not ready to consider any change in the cotton regime at this point in time. Brazil therefore prepared a long list of products to retaliate against the US and announced that it was ready for implementation.

Upon this threat, the US fielded a high ranking mission to Brazil which - for the first time in several years – signalled a readiness to negotiate.

Content of the 5th of April “deal”

The US proposed the following actions as a down payment to avoid retaliation and to continue the negotiations towards a settlement:

- “The United States agreed to make some near term modifications to the operation of the GSM-102 Export Credit Guarantee Program, and to engage with the Government of Brazil in technical discussions regarding further operation of the program”. This is a very first and welcome step towards compliance by the US with at least some elements of WTO obligations. The US has an authorization for \$ 5.5 bio in export credit guarantees. \$ 2.7 bio of those guarantees have been allocated and \$ 1.9 bio have been used up to now. The unused proportion of the credit will be withdrawn and put into a new and revised scheme to be determined.
- To compensate the Brazilians with “approximately \$147.3 million per year (...) to provide technical assistance and capacity building [for cotton]. The fund would continue until passage of the next Farm Bill or a mutually agreed solution to the Cotton dispute is reached, whichever is sooner.” The amount represents the value of the retaliation the WTO had authorized for American payments to cotton producers under a marketing loan and a countercyclical loan program;
- As part of the US compensation package to Brazil, the US also agreed to move forward with a proposed rule on a completely unrelated SPS issue. Accepting to propose a procedure to declare a specific state in Brazil to be free of certain animal diseases is certainly of interest to Brazil. Giving as a concession a right that should be based on scientific criteria is politicising an issue and does not strengthen the rule-based system.

Based on this US proposal, Brazil and the US agreed on the 5th of April on the **following procedural arrangement:**

1. Brazil agreed to postpone implementation of its retaliatory measures for the moment;

2. The USA and Brazil agreed to operationalise the three measures mentioned above until the 22nd of April 2010;

3. If there is a satisfactory agreement on this three proposals, the USA and Brazil agreed to negotiate – within 60 days – an outcome of the dispute to be submitted by the US administration to Congress during the revision of the Farm Bill to be adopted in 2012;

4. If there is agreement on the outcome, Brazil will postpone any retaliatory measure until the negotiated outcome is accepted by the US Congress in form of the new Farm Bill scheduled for 2012.

The final verdict about this deal is therefore still out. On the positive side, the agreement recognises the political realities in both countries and allows more time to adjust to WTO obligations while partially compensating for the harm done by the US subsidies. It also keeps up the pressure on the US to comply with WTO obligations which is the final goal of the WTO dispute settlement. On the negative side, it leaves other cotton producers like the African ones out in the cold: they continue to suffer from US subsidies – at least until 2012. Moreover, by satisfying – at least temporarily – Brazil, one of the big players in WTO, the US is even further isolating the African cotton producing countries. These countries are – for practical purposes - unable to benefit from the dispute settlement process due to the lack of retaliation possibilities.

What does all this mean for the players involved?

Brazil can clearly claim some success in this temporary agreement:

- It has forced the US to enter into concrete negotiations on a topic the US has refused to seriously discuss both within the dispute settlement mechanism and the Doha Round negotiations.
- It has avoided to have to apply sanctions against US interests – which are controversial within Brazil - and can maintain the threat of sanctions until a final agreement is reached;

- It has forced the US to address at least one issue (the export guarantee scheme) in a systemic way in (hopefully) full compliance with WTO requirements;
- It will receive financial compensation.

The US can also be satisfied:

- It has avoided retaliatory measures by Brazil – at least in the short term;
- It has gained valuable time: any solution to the conflict will only have to be implemented with the new farm bill, which is politically very important to the US;
- It has the possibility to get “paid” twice for the same concession. It is likely – or even certain – that the US will sell its compliance with the obligations of the dispute as their contribution to the cotton outcome of the Doha negotiations.

The “jubilation” of the main US cotton growers’ association (National Cotton Council of America) might, however, be premature: the fact that the US tax payers will have to “subsidise” Brazilian cotton growers to continue their massive subsidies to some 25’000 US cotton growers might not be very popular with public support for the subsidy program and certainly provides an additional incentive to review that policy – especially in a time of severe budgetary constraints.

The multilateral trading system is affected both positively and negatively by this preliminary temporary agreement:

- It is certainly positive that the US has finally entered into serious negotiations to comply with the WTO dispute settlement outcome. This shows that even the US cannot simply ignore multilateral rules – at least, when the other party to the conflict is a country with a certain economic power. The fact that – at least partially - the agreement may lead to the redress of a WTO non-conform measure (the export guarantee credit scheme) is another victory for the system. The final verdict about the systemic impact of this temporary agreement will, however, be contingent upon the outcome of the final settlement. This will depend on Brazil’s steadfastness in the upcoming negotiations.

- The interim agreement also shows the limitations of the multilateral system. It shows that the big powers can only be brought to the negotiating table on the basis of economic pressure and power, while multilateral trade rules have as their objective to protect the weak from arbitrary use of economic power. The fact that Brazil gets compensation while the African countries are unable to make their legitimate case heard certainly does not contribute to the belief that the multilateral system is fair and all inclusive. Again, it would be premature to be pessimistic: it might well be that the interim deal will lead to a more rule-based system. All depends whether Brazil will use the upcoming negotiations to defend narrow national interests or whether Brazil is fully taking up its responsibility towards the multilateral rule-based system. Brazil is and wants to be a major player in the WTO and its President presents himself as the defender of the interests of the poorer countries. It has now the possibility to show that it is fully aware of the obligations of such a position.

Africa has nothing gained in this interim agreement and appears as the big loser. BUT, Africa has nothing lost either: everything depends on whether this interim agreement leads to systemic changes in US policy or in some bilateral accommodations of the Brazilian interests. One thing is sure now: any change in US cotton policy will have to wait until the 2012 Farm Bill. The African cotton producing countries have to make a strategic choice:

- Take this interim agreement and the promises to compensate Brazil, but not Africa, as a proof that the multilateral trading system is not responsive to their legitimate concerns and resign. While such a position may seem justified, it would be a big mistake both for Africa and the multilateral system;
- Take this interim agreement as an incentive to get into the discussions with the US to assure that the final agreement leads to a change in the US cotton scheme that also addresses the legitimate claims of African countries.

African cotton producing countries have to accept the reality that any change in both US and EU cotton policies will have to wait for the new US Farm Bill (2012) and the

EU revision of the Common Agricultural Policy (2013). **This might seem far away, but requires urgent actions:**

- Brazil and the US are supposed to agree on the content of a settlement within some 60 days. It seems highly likely that this settlement will be the US administration proposal to Congress and therefore also the US position in the Doha Round. The African countries have to be brought into those bilateral discussions. This is also in the interest of Brazil and the US and therefore should be possible. **African cotton producing countries have therefore to be ready to define and defend their bottom line in the next 60 days.**

- The EU is defining the guidelines of the reform of the CAP this year. Once the basic approach is defined, it will be difficult to bring in new concerns. **African cotton producing countries have therefore to define their negotiating strategy towards the EU in the next months and start a strong lobbying effort towards the EU both at the levels of the Commission and the European Parliament.**

The Doha negotiations in Geneva are no longer the only battlefield for the African countries. The Doha Round will not define US and EU cotton policies for the future. Quite to the contrary: it is the US-Brazil negotiations that will define the US Farm Bill and it will be that Farm Bill that will define the US position in the Doha negotiations. It will be the reform of the European Common Agricultural Policy that will determine EU's position in multilateral trade talks and not Doha that will define the EU CAP reform. **And the time for the African countries to influence those two major legislative acts is now in, Washington, Brussels and Brazil, not in Geneva.** This said, the Doha Round remains the only trump card the Africans still have in their hands to influence Brussels and Washington. **It is therefore crucial for the Africans to keep Doha alive.**

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