# *Brazil's WTO Challenge Against U.S. Cotton and Export Credit Programs*


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# Case Timeline

- **Sept. 2002**. Brazil requests consultations
- **Mar. 2003**. Panel established
- **Jun. 2004**. Final report issued
- **Oct. 2004**. Notice of appeals
- **Mar. 2005**. Appellate Body report adopted
- **Aug. 2006**. Brazil requests compliance panel
- **Dec. 2007**. Compliance report issued
- **Feb. 2008**. U.S. & Brazil appeal
- **June 2008**. Appellate Body report issued
- **July 2008.** Brazil resumes arbitration process
- **Aug. 2009.** Arbitration award announced

# Why Cotton?

- Starting in late 1990s falling commodity prices, increasing U.S. subsidies
- Growing Brazil frustration over prices, U.S. subsidies
- Looked to soybeans first
- 2001/02 cotton price collapse →Brazil switches to cotton for WTO challenge

# U.S. Cotton Under the WTO Gun

- Peace Clause:  Did cotton support exceed that in 1992?
- Serious Prejudice: Marketing loans, MLA/CCPs, PFC/DPs, Step 2, crop insurance suppress world prices
- Step 2: prohibited export subsidy and import substitution subsidy
- Export Credit Guarantees: prohibited export subsidies for cotton and other unscheduled commodities

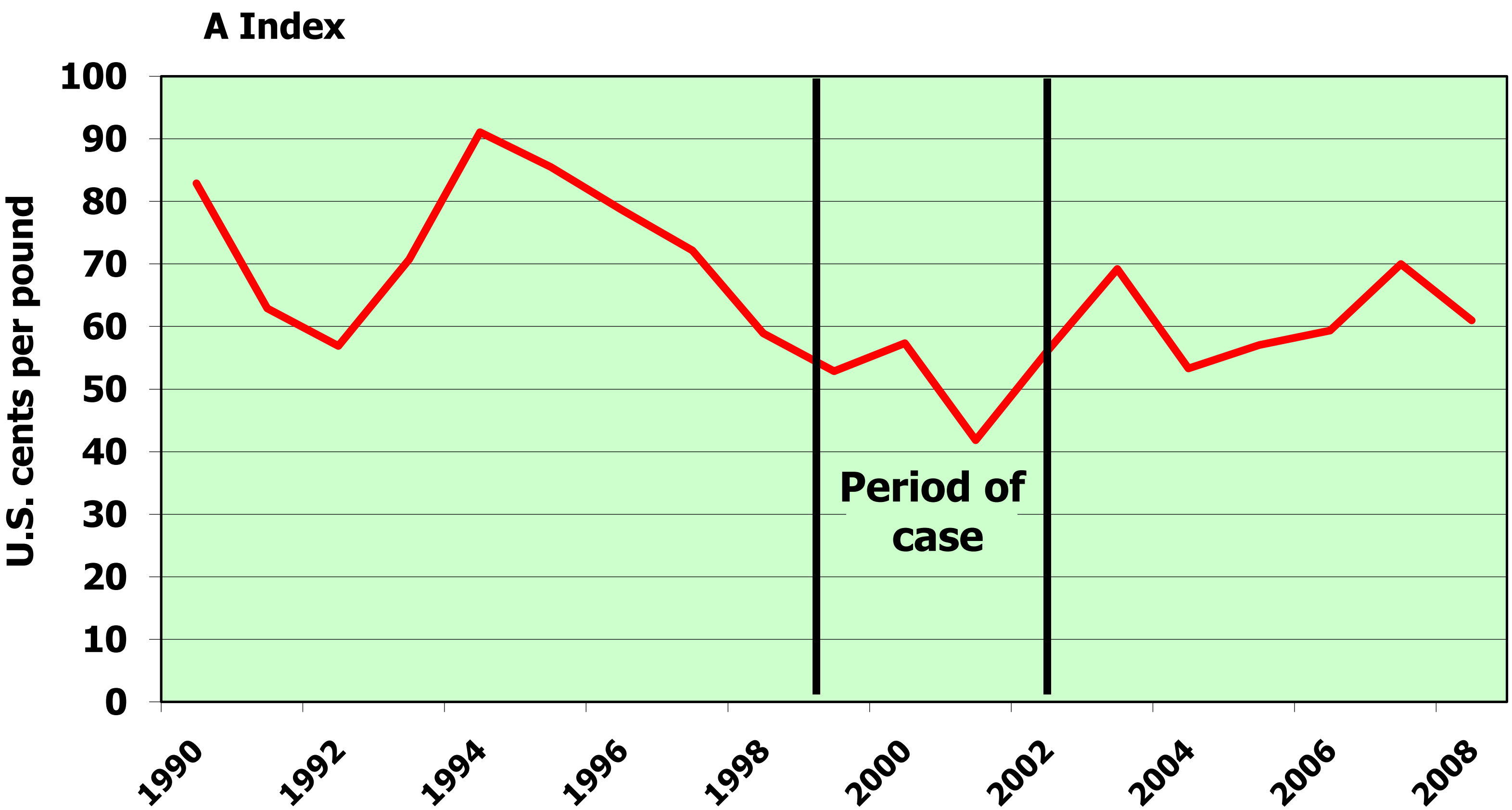
# Peace Clause Issues

- Planting restrictions for decoupled programs (PFCs, Direct Payments)
- Base updating for 2002 Farm Act (from PFCs to DPs) – what is “fixed, defined base period?”
- How to measure support from decoupled programs (planted versus base acres)

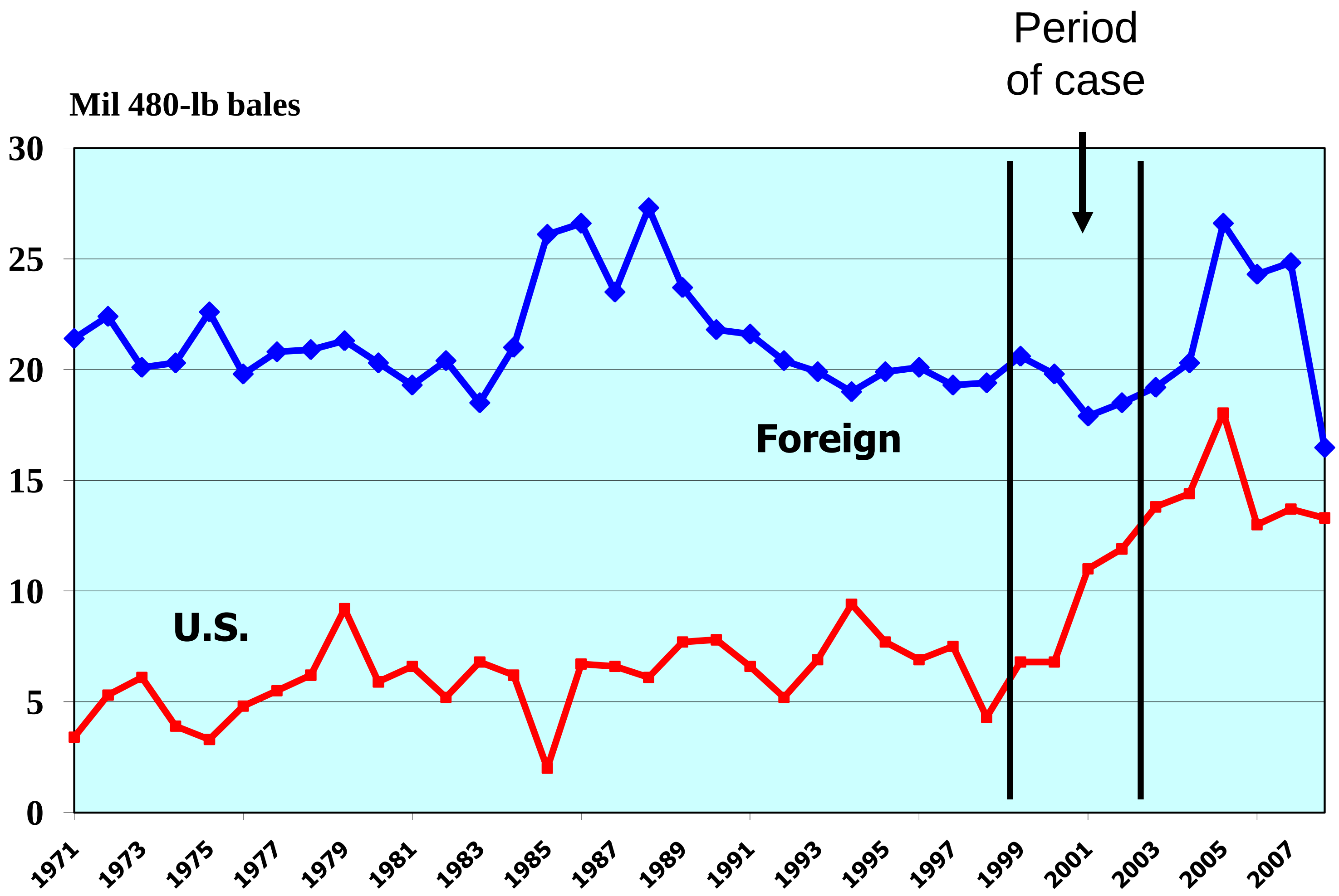
# Brazil's Fundamental Arguments

- Causal link between U.S. subsidies and significant price suppression
- As world prices fell between 1999-2002, U.S. subsidies increased
- U.S. production and exports grew, world export share increased sharply
- Cost of production exceeded market revenue, subsidies made up the difference (cost-revenue gap)

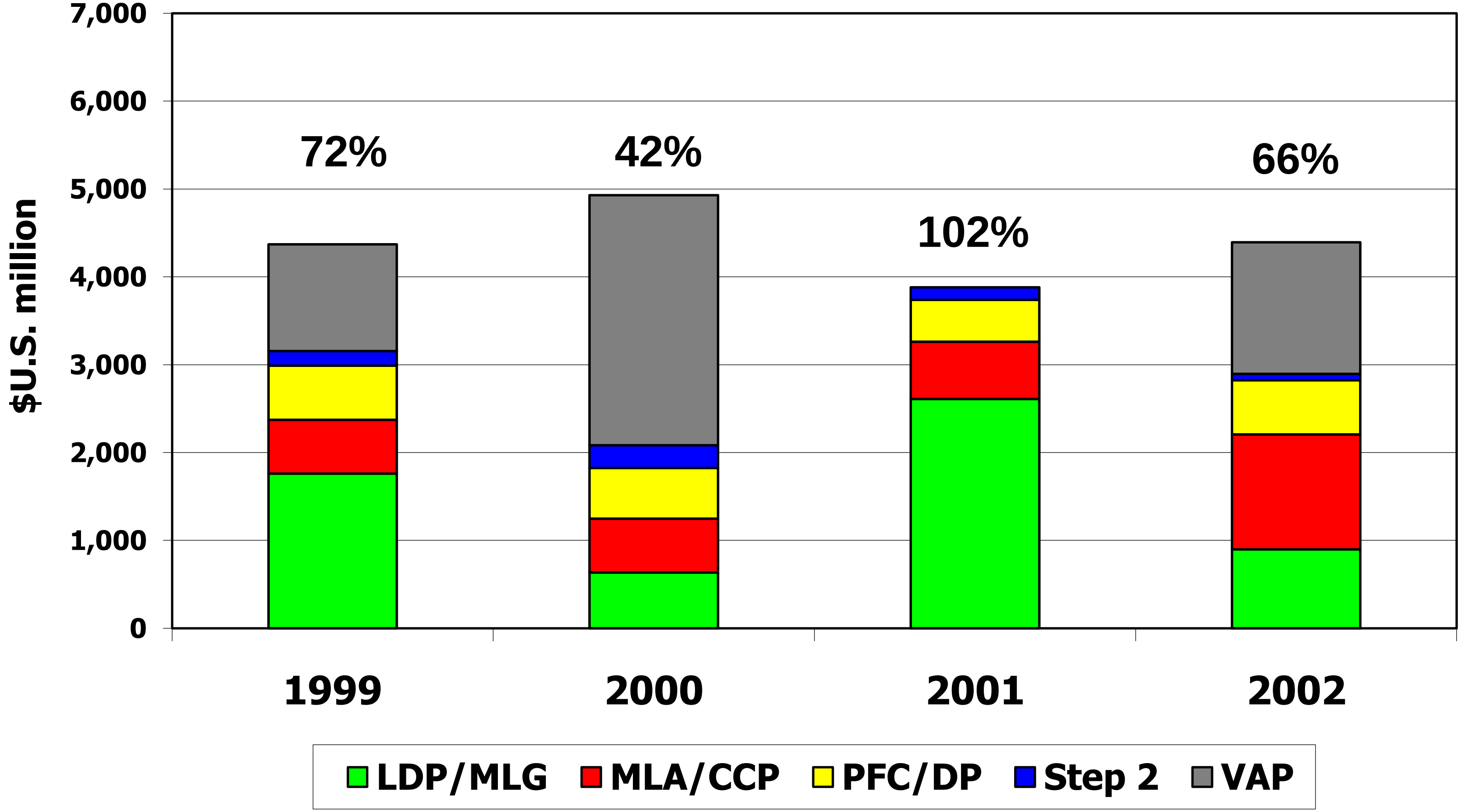
# World Cotton Prices Fell Sharply



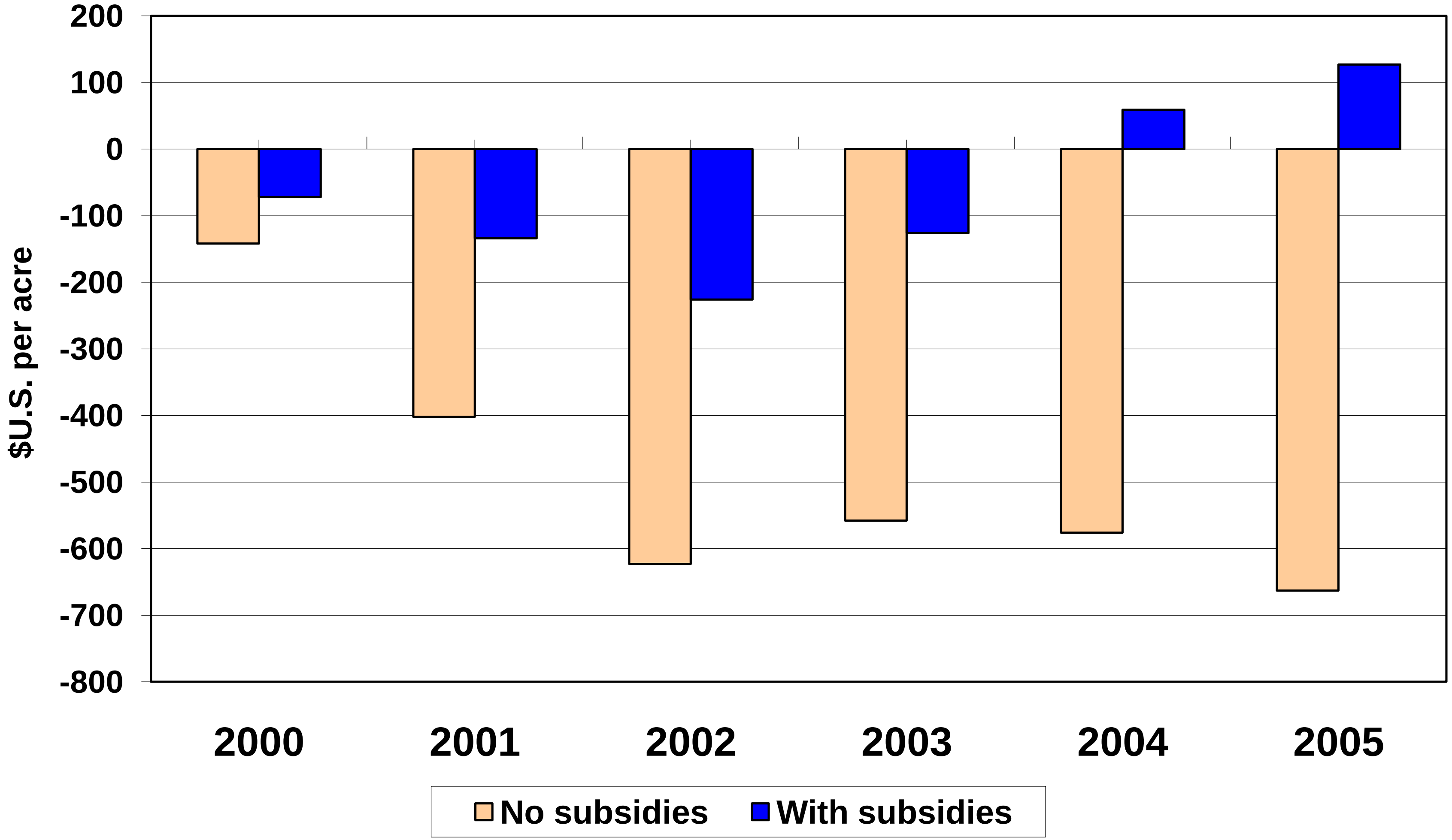
# U.S. Cotton Exports Increased Sharply



# What Affects U.S. Production and Exports – Brazil's View



# Brazil: U.S. Cost – Revenue Gap Filled by Subsidies



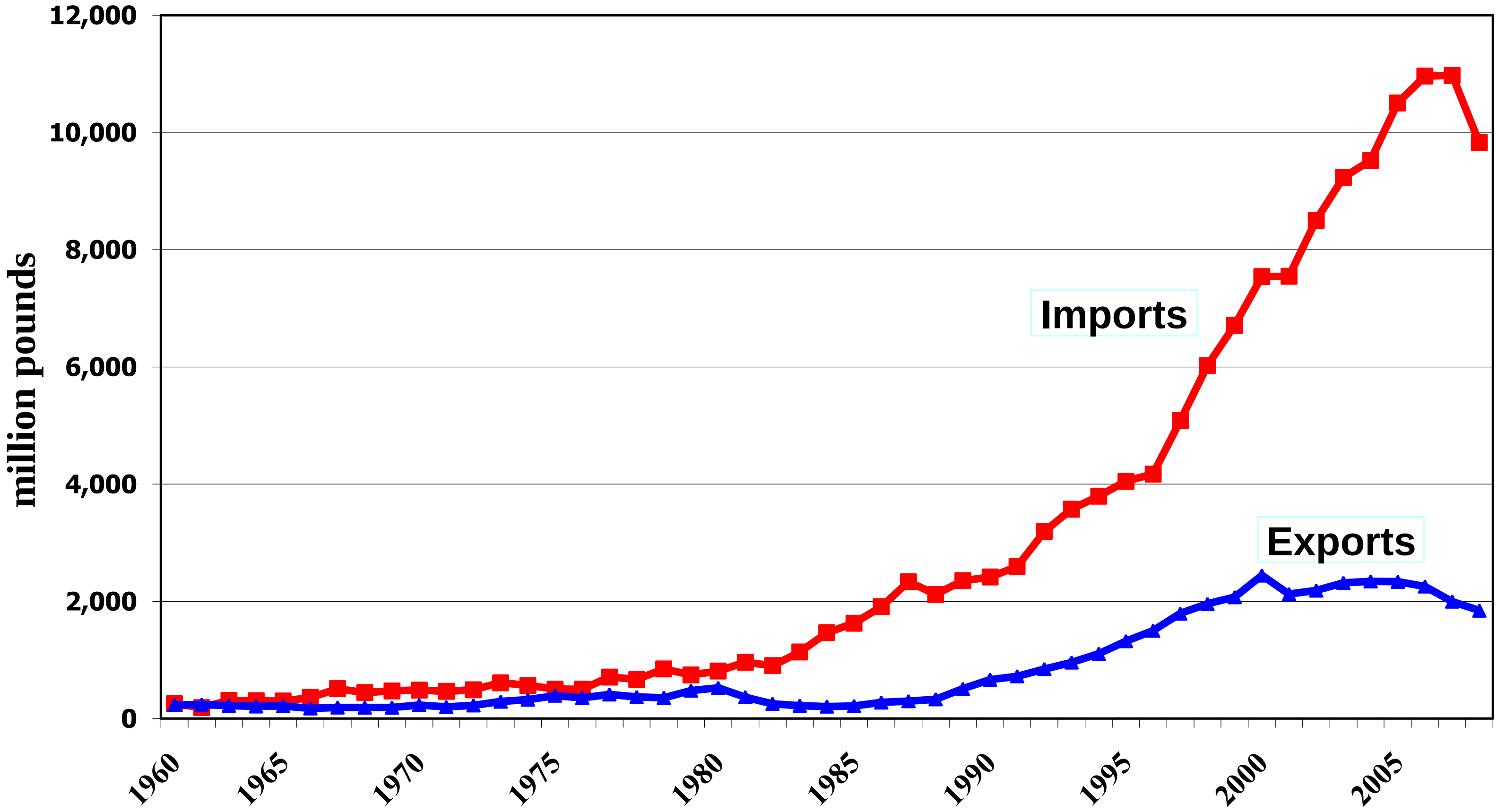
# Model Results Buttress Arguments

- Dr. Sumner's FAPRI-like model introduced in September 2003
- Included all domestic and export programs
- *"But for U.S. subsidies"* analysis for 1999-2002:
  - U.S. production ↑ 29%
  - U.S. exports ↑ 41%
  - Prices ↓ 13%

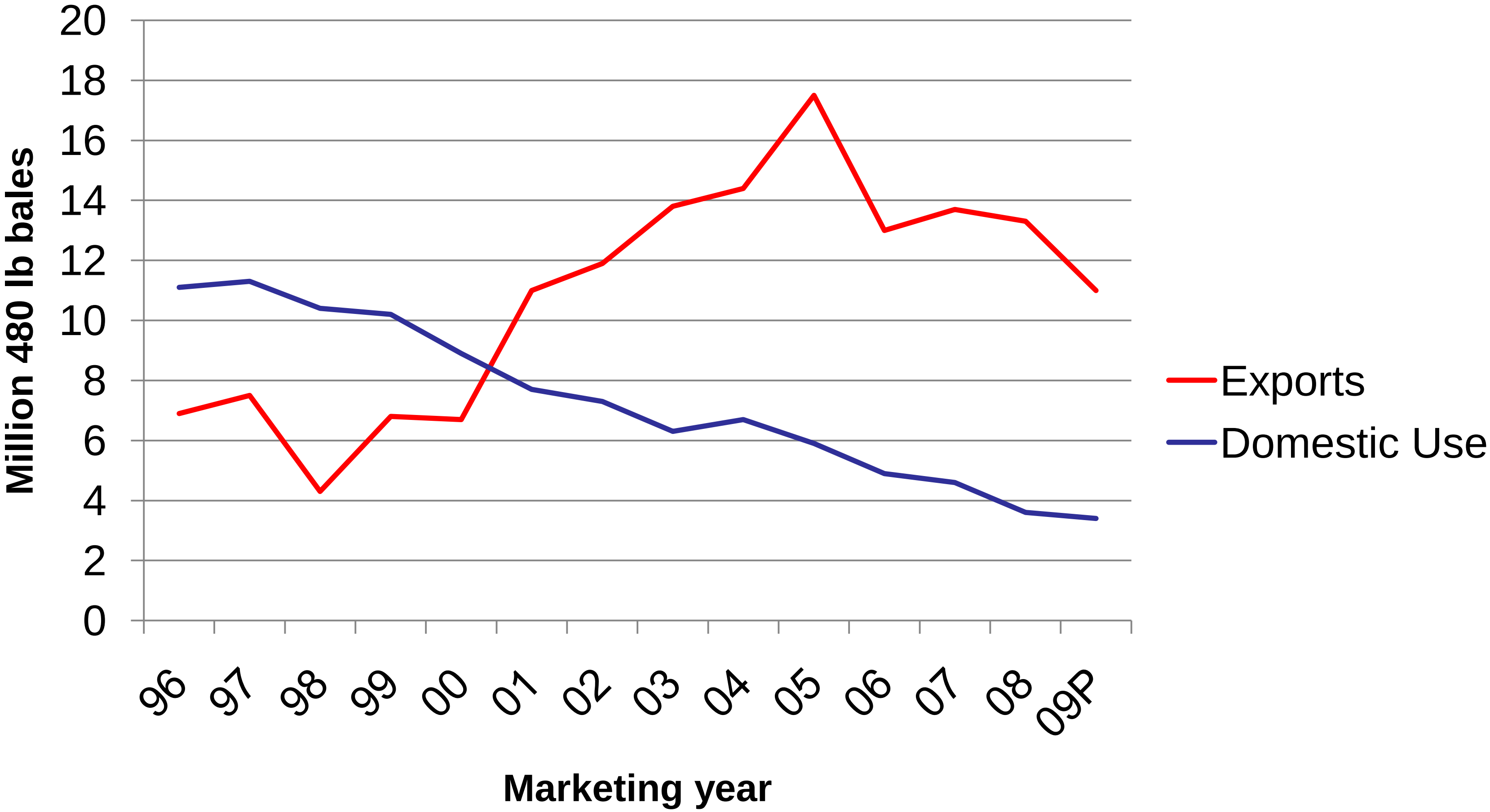
# U.S. Rebuttal

- Other factors drove down world prices – economic weakness reduced demand for cotton and textiles, declining U.S. textile industry, China dumped surplus stocks
- Role of technology – boll weevil programs and biotech seed encouraged planting
- Brazil’s cost-revenue gap analysis was flawed – used total COP not variable costs

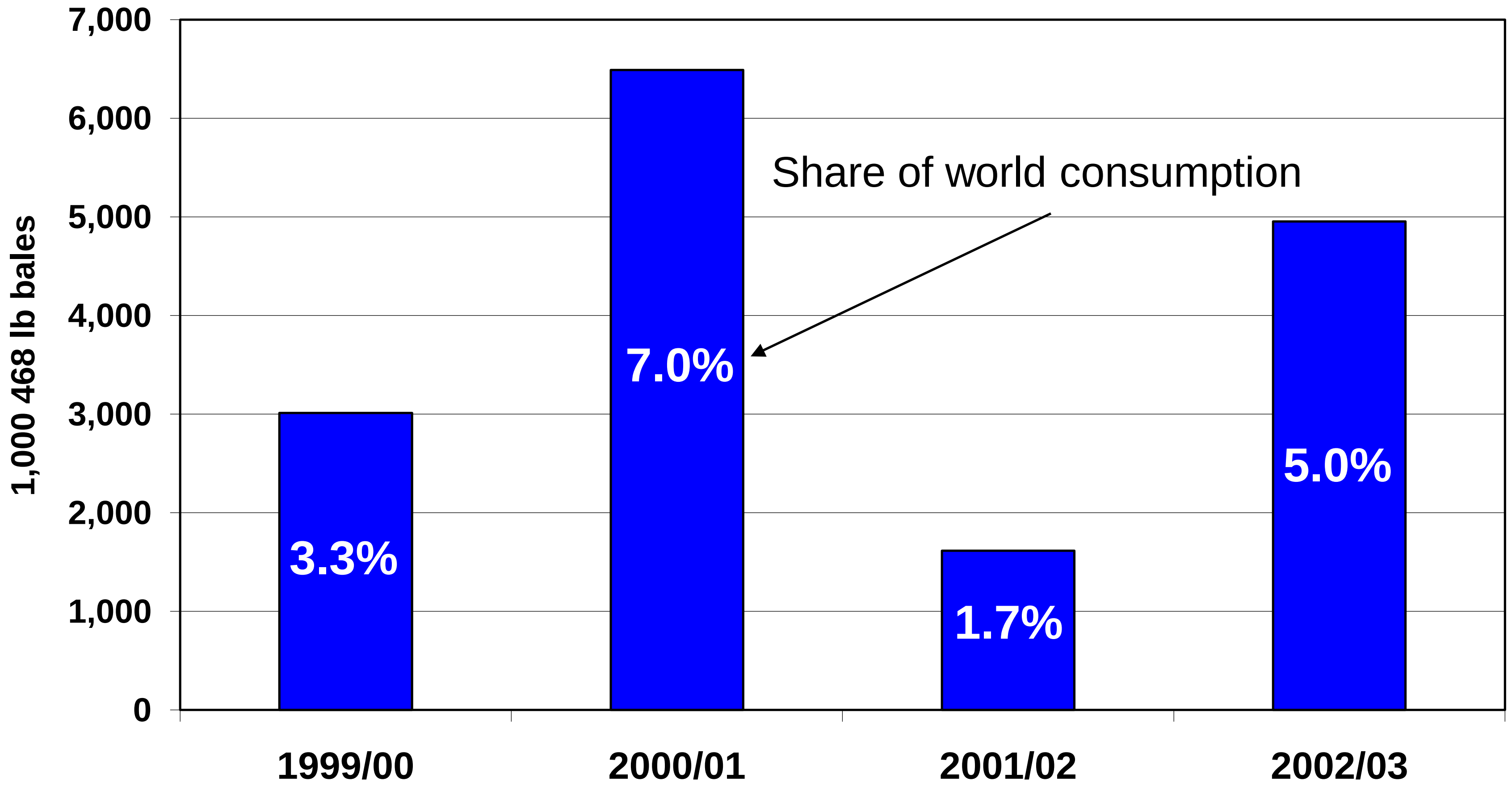
# Cotton Equivalent of U.S. Textile Trade



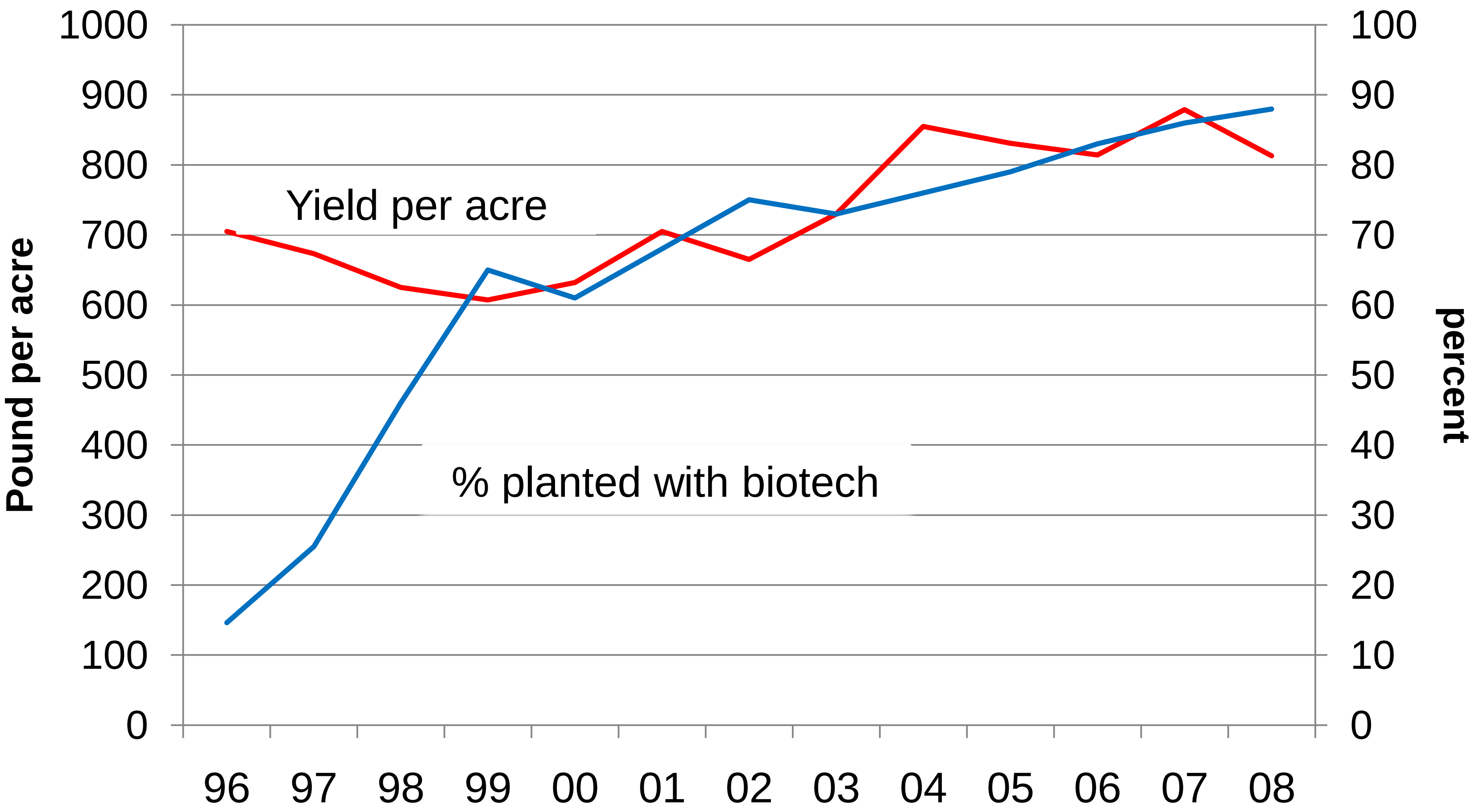
# Shift from Domestic Use to Exports



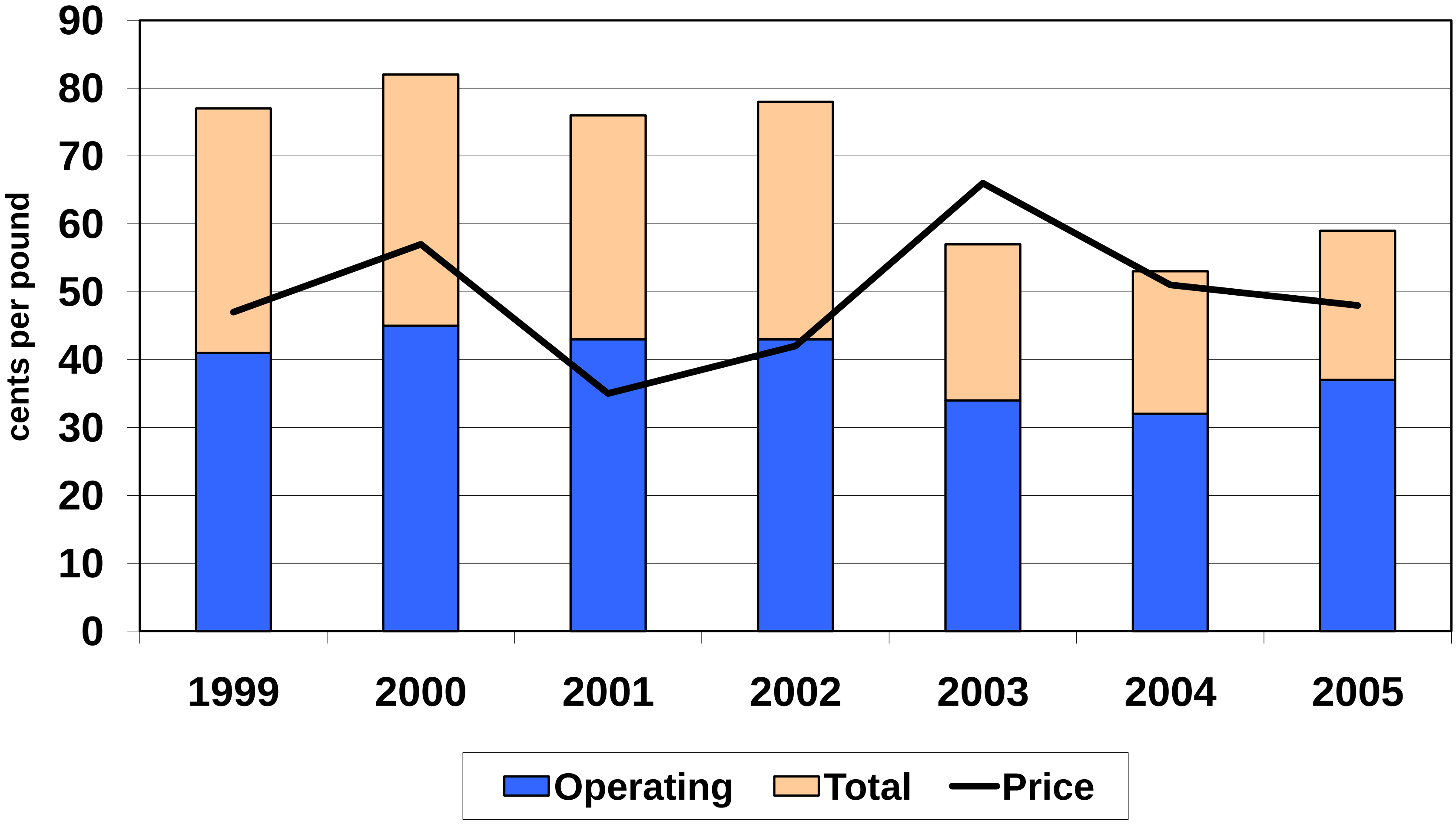
# Chinese Flood Cotton Markets



# Role of Technology



# U.S.: There Is No Gap



# Brazil Mischaracterized Effects of U.S. Programs

- Decoupled payments don’t affect production decisions – data on base vs. planted acres
- Marketing loan effects only when expected prices are below loan rate (futures prices and planting decisions)
- Can’t simply aggregate payments to determine effects (stacked bar approach is flawed)
- *U.S. payments were a response to low prices, not a cause*

# Sumner’s Model Is Flawed

- Using baseline model to backcast is inappropriate
- Using lagged prices misses the planting decision
- Used wrong elasticities and coefficients, especially for decoupled programs
- Disagreed with treatment of crop insurance, export credit guarantees, etc.

# Export Credit Guarantees

- Challenge extended to all commodities, not just cotton
- Item J argument from SCM Agreement (fees cover long term costs and losses)
- Brazil used USDA budget data that showed annual subsidy every year
- U.S. used 10 years of budget data to demonstrate no subsidy over “long term”

# Panel Findings

- Direct Payments don’t meet green box criteria; 1992 support was exceeded (planting limits)
- Step 2 is both prohibited export subsidy and import substitution subsidy
- Export credit guarantees are export subsidies, prohibited for cotton and non-scheduled products
- PFCs, Direct Payments, crop insurance did not contribute to serious prejudice (not price contingent, no price suppression)
- Marketing loans, MLA, CCPs, Step 2 did cause significant price suppression (price contingent)

# Panel Reasoning

- Dominant U.S. role in world cotton markets
- Nature of price-contingent subsidies
- “Discernable temporal coincidence” of low prices and large U.S. subsidies
- Gap between total costs of production and revenue from cotton sales
- Economic models – general recognition of results, no substantive role in decision

# Appeal Process

- U.S. appealed most decisions, to no avail
- Found "cotton-to-cotton" method for decoupled payments appropriate – not all payments are support to cotton
- AB dinged Panel for lack of explanation of economic reasoning; should have been more clear how it used economic analysis
- But found no legal error

# Compliance Process

- Eliminate *prohibited subsidies* by 7/1/05
  - U.S. adjusted GSM, July 1, 2005
  - Eliminates use of GSM 103 and SCGP
  - Step 2 eliminated as of Aug. 1, 2006
- Address *serious prejudice* by 9/21/05
- Brazil requests compliance panel in September 2006
- Brazil presents new model (Sumner II, spreadsheet based)

# Sumner II Results

- More transparent; tried to address Panel issues
- 3 different price expectations, 7 subsidies
- Numerous scenarios for 1999-2008

| 2005 results | World price | Production | Exports |
|---|---|---|---|
| All subsidies | 13-15% ↑ | 24-28% ↓ | 33-38% ↓ |
| MAL/CCPs | 9-11% ↑ | 17-19% ↓ | 25-27% ↓ |

# Compliance and Appeal

- Lengthy debate over model parameters
- U.S. re-ran Sumner II – for 2002-2005 world prices only 1.4-2.3% lower
- Final report on 12/18/07 – U.S. not in compliance
  - Marketing loans and CCPs continue to cause price suppression, eliminating Step 2 was insufficient
  - Changes to export credit program were insufficient

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- U.S. appeals (again) – same result
- Panel and AB noted even U.S. re-runs showed price suppressing effects of cotton subsidies

# Arbitration Process

- Brazil requests:
  - $350 million for late removal of Step 2
  - $1.294 billion for GSM 102
  - $1.037 billion for serious prejudice (Sumner model calculates $3.35 billion)
  - Right to cross-retaliate (non-goods sectors)
- U.S. responds:
  - $9.456 million for GSM 102
  - $30.4 million for serious prejudice

# Brazil's Method for Serious Prejudice

- Used Sumner II for 2005
  - World prices ↓ 10.75%
  - U.S. production ↑ 18.8%
  - U.S. exports ↑ 24%
- Adverse effects: $2.73 bil. in sales value effects and $605 mil. in reduced production effects (global effects)

# For Export Credit Guarantees

- Measured interest rate subsidy using Ohlin formula ($270 mil.) for 2006
- Key item – assumptions for creditworthy and non-creditworthy banks
- Measure of additionality
  - Full: no sales without GSM ($985 mil)
  - Marginal: some sales, used partial equilibrium model ($39.93 mil)

# U.S. Methods

- Emphasized dramatic shrinkage in U.S. cotton sector
- Tinkered with Sumner II (short-run vs. long run elasticities, price expectations)
- Damages only apply to Brazil, not global
- GSM – cost to government, based on 2005-2007 budget data

# Arbitrator’s Decisions

- Used Sumner II – 9.38% world price effect, $2.9 bil. in global adverse effects in 2005
- Level of $147.3 mil (fixed) based on Brazil’s share of world cotton production (5.1%)
- Accepted Brazil’s concept of IRS, additionality
- Rejected Brazil’s model, effects only on Brazil
- Level of $147.4 for FY2006 but devised formula for future years (level of GSM, Brazil banks)
- Cross retaliation once import trigger is hit ($409.7 mil for 2006), adjusted for import

# Where Things Stand

- Brazil requested U.S. GSM data for FY2008 and 2009 (Sept)
- Brazil requested authority to retaliate (Nov)
- Brazil has preliminary list of goods
- Working on procedures to address retaliation on services, IPR
- Brazil estimates retaliation at $800 mil. for FY2008 (GSM 102 use doubled in FY2009)

# Stuff to Ponder

- Impact on Doha – C-4 cotton issues, export credit negotiations, green box criteria, product-specific caps
- Conflict between green box and SCM?
- Role of economic analysis and research (*but for* analysis proved compelling, research on decoupled payments)
- Sumner’s model had greatest impact at the end of the process (arbitration)
- Did the panels get it right? Timing may be everything