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The WTO Decision on U.S. Cotton Policy

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Market Report	Yr Ago	4 Wks Ago	3/9/07
Livestock and Products, Weekly Average			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight	$85.43	$89.69	$98.10
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb	131.67	117.90	127.35
Nebraska Feeder Steers, Calves Med. & Large Frame 750-800 lb	106.16	99.26	104.82
Choice Boxed Beef, 600-750 lb. Carcass	148.22	143.34	155.70
Western Corn Belt Base Hog Price Carcass, Negotiated	57.86	64.33	59.42
Feeder Pigs, National Direct 50 lbs, FOB	56.44	68.27	76.30
Pork Carcass Cutout, 185 lb. Carcass, 51-52% Lean	65.70	63.37	68.32
Slaughter Lambs, Ch. & Pr., Heavy, Wooled, South Dakota, Direct	79.00	88.37	85.25
National Carcass Lamb Cutout, FOB	215.73	240.14	244.63
Crops, Daily Spot Prices			
Wheat, No. 1, H.W. Imperial, bu	4.08	4.36	4.59
Corn, No. 2, Yellow Omaha, bu	1.93	3.84	3.90
Soybeans, No. 1, Yellow Omaha, bu	5.42	6.98	7.13
Grain Sorghum, No. 2, Yellow Columbus, cwt	2.86	6.23	6.48
Oats, No. 2, Heavy Minneapolis, MN , bu	1.99	2.64	2.74
Hay			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton	130.00	135.00	*
Alfalfa, Large Rounds, Good Platte Valley, ton	65.00	92.50	*
Grass Hay, Large Rounds, Good Northeast Nebraska, ton	55.00	90.00	*

* No market.

In 2002, Brazil filed a complaint about U.S. cotton policies with the World Trade Organization (WTO). After initial consultations and review of the Brazilian complaint, the WTO established a dispute resolution panel in March 2003. The panel returned a ruling in favor of most of the objections in Brazil's petition in September 2004. The United States appealed this decision but the WTO Appellate Body upheld the original judgment in a ruling issued on March 3, 2005. The cotton subsidy case is of importance for the U.S. cotton industry, but it also has implications for other U.S. commodities. The federal programs used to support grains and oilseeds are similar to the ones found to be in violation of the United States' WTO commitments in the cotton case.

Textile production in the United States has been in decline for many years as a result of competition from low-cost producers in Asia. In addition, an international agreement known as the Multi-Fiber Agreement (MFA) that had protected U.S. textile mills was terminated in January 2005, and this may have accelerated the decline of U.S. textile manufacturing. As domestic demand for cotton has fallen, the proportion of the cotton crop that is exported has increased. In recent years, more than 75 percent of the cotton produced in the United States has been exported and the United States now accounts for almost 40 percent of world cotton exports. Prior to 2001, U.S. cotton exports were generally in the range of 5 to 7 million bales per year, averaging about 43 percent of total U.S. production. In 2005, U.S. exports reached 18 million bales (ERS/USDA).

Brazil's action was triggered in part by a precipitous decline in the world cotton price, which fell 55 percent between 1994 and 2001. The Brazilian government argued that lower prices were the result of U.S. cotton subsidies. Cotton policies in the United States have been referred to as a "Three-Step Competitiveness Program" (Shurley). Step One is the marketing loan program (including loan deficiency payments) that is available for other program crops. The Step Two program provided marketing certificates to compensate U.S. cotton exporters and domestic cotton users for the difference between U.S. prices and lower world prices. Step Three allows for increases in the U.S. import quota if there appear to be shortages in the United States

(Shurley). In addition to these program elements, cotton producers benefit from direct and counter-cyclical payments as defined in the 2002 Farm Bill and export programs such as the GSM 102 and GSM 103 programs which provide export credit guarantees.

The Brazilian complaint challenged all of these policies and included statistical evidence that U.S. policies had caused world prices to fall, costing Brazil an estimated $600 million in 2001 (Schnepf, 2005). The dispute resolution panel identified certain U.S. cotton programs as “prohibited” subsidies while others were classed as “actionable” subsidies. The panel ruled that prohibited subsidies be eliminated within six months of the ruling and that the actionable subsidies be modified so as to remove the parts that were causing damage to Brazil and other cotton exporters (Schnepf, 2006). The prohibited subsidies are the Step Two program and the export credit guarantees (GSM 102/103). The U.S. government eliminated the Step Two program in August 2006 while the subsidy elements in the export credit guarantee programs were removed in 2005 (Schnepf, 2006).

The actionable subsidies include marketing loan provisions and counter-cyclical payments. For these subsidies, the United States is encouraged to make modifications in its policies so that they would no longer cause serious adverse effects in Brazil. To fully understand the implications of this part of the ruling, it is necessary to review the provisions of the WTO Agreement on Agriculture (AA) with respect to trade-distorting domestic policies. The AA established three boxes into which various agricultural policies are classed. Policies such as conservation programs that have little impact on trade are placed in the green box and need not be adjusted. Policies identified as trade distorting are placed in the amber box and the AA requires an average reduction in these policies of 21 percent relative to an aggregate measure of support. The third box, the blue box, is for policies that may influence production decisions and therefore have trade distorting effects but are contingent on production controls or other measures that offset the trade effects. Blue box policies do not need to be modified to comply with the AA.

In the past, the United States has argued that direct payments, counter-cyclical payments and the marketing loan program should be placed in the blue box. The dispute resolution panel in the cotton case ruled to the contrary, that these are amber box policies subject to the limitations applied to other trade-distorting domestic policies. So far, the particular actions to be taken by the United States to comply with the ruling on actionable cotton subsidies are still being worked out. According to one source, Brazil has elected not to pursue the actionable subsidies for the time being because of the expectation that these will be modified in the course of the Doha Round of trade negotiations (Schnepf, 2006).

Most analyses of the impact of the cotton policy changes that have been made or that may be made in the future suggest that there will be fairly limited impacts on cotton prices and trade. A study by the Food and Agricultural Policy Research Institute (FAPRI) predicted a decline of less than 2 percent in the volume of U.S. exports, a decline of 1.3 cents per pound in U.S. cotton prices and an increase of 0.4 cents per pound in the world price as a result of eliminating the Step Two program. Note that the loan rate for U.S. upland cotton was set at 52 cents per pound for 2002-2007. It may turn out, however, that in the long-run these policy changes will have greater impacts on the U.S. cotton industry. The International Cotton Advisory Committee found that the cost of producing cotton in the United States is the highest in the world suggesting that the United States does not have a comparative advantage in cotton. Under these circumstances, the U.S. cotton sector would be expected to decline quite substantially over time if the subsidies are eliminated.

Beyond the immediate effects on U.S. cotton, the WTO decision has important implications for other agricultural sectors in the United States. Encouraged by the precedent set by the cotton case, Canada filed a complaint against the U.S. corn program in January 2007, citing many of the same programs that had been found actionable in the cotton case (Schnepf, 2007). If the cotton decision is carried over to other commodities, marketing loan provisions, counter-cyclical payments and direct payments all risk being reclassified as amber box policies that would be subject to reductions. In 2007, a new Farm Bill will be crafted and the Bush administration has proposed shifting the orientation of this bill in favor of conservation programs and biofuel research at the expense of some of the programs that have been challenged in the WTO. This reorientation of farm policy in the United States may be due in part to the ruling on Brazil’s cotton complaint. Of course, more traditional approaches to farm policy may be reinstated by the House and Senate but it is likely that the U.S. government will find that it is in the broad national interest to pay close attention to the cotton decision as it crafts future farm legislation.

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