



Information, Thoughts, and Comments Concerning the WTO Ruling on US Cotton.....

The cotton market (prices) have reacted negatively to a WTO panel's preliminary ruling released this week that finds portions of the US cotton government program and other subsidies in violation of WTO guidelines. While this ruling is not final and surely will be appealed (which could take months or years and thus is not likely to have a bearing on the demand for and export of US cotton for 2004-2005), the market nevertheless went into shock this week. I would think a recovery will eventually be in order, but this ruling possibly has significant longer-term implications for US cotton producers.

I want to make a few comments and observations on this WTO decision-- but this must be done judiciously for several reasons. First of all, the text of the ruling has not been publicly released thus we can only know what has been said and written in the media. Secondly, the most knowledgeable people on this issue are those directly involved in the negotiations and those in positions of leadership that have had a need to keep informed on a day-to-date, week-to-week basis... so, that excludes me (and most of us, for that matter). Thirdly, the outcome of this ruling, if it stands, will be the result of both economic and political forces. The truth is no one at this point in time knows for sure what this means for US cotton. Granted, it doesn't sound good but the impact and implications at this point are only educated guesses, or at best, only somewhat reasonable estimates.

So the following has been gleaned primarily from many secondary sources. Accuracy, opinion, and analysis, therefore, are based on what may be less than perfect information.

In the way of a very brief history... In September 2002, Brazil requested and began discussion with the US about concerns with various aspects of the US cotton subsidies including export credit programs. These discussions produced no satisfactory result. In March 2003, Brazil requested that a panel be formed to rule on it's complaint. Brazil claimed that US cotton subsidies violated certain aspects of the WTO agreement and generally were unfair to cotton producers in South America (Brazil). Continued disagreements over farm support programs and subsidies were the reasons for the breakdown of WTO talks in Cancun, Mexico in September 2003. On April 26, 2004 this week the panel appointed to the US/Brazil dispute issued an interim report, ruling in favor of Brazil.

Some specifics of the complaints... Brazil contends that because of subsidies, the US has been able to increase cotton production and exports. The claim is that subsidized US production forces prices lower, harming producers in lesser-developed countries without such subsidies, and that increased exports have resulted in an unfair market share and, therefore, access denied to other countries. Export credit programs and Step 2 payments were specifically mentioned (In general terms, Step 2 is a payment to US cotton exporters for the difference between the price of US cotton on the world market and the average price for the 5 cheapest competitors). Brazil alleged that from 1999-2003, prices received by US cotton producers were 77% below the average cost of production yet production continued to increase due to \$12.47 billion in subsidies over that period.

Brazil has a lot at stake... Brazil is the world's 5th largest cotton producer, producing 5.4 million bales in 2003. Yield has improved tremendously over the past 8-10 years and production has more than doubled since 1998. Brazil is now a net exporter of cotton and it is widely known and accepted that Brazil has potential for significant further production and exports. But it's not just Brazil. Farmers in other countries (such as in Africa) have also complained about US cotton subsidies.

The US response... The US will most surely appeal the panel ruling. US agriculture officials, cotton industry leaders, and farm policy legislators have stated they believe the report is erroneous in it's claims and that US farm program payments are either not subsidies as defined by WTO and/or are in compliance with WTO restrictions

and guidelines. The appeals process could take months or perhaps even years. Officials say that subsidies are safe in the meantime.

Interesting other responses... Reactions from other countries, other commodity organizations, the media (domestic and foreign), and academia have been varied. One type reaction seems to be of the attitude that it's about time the US got slapped for its subsidies and unfair policies. One source even called the US immoral for its farm programs and alleged effect on lesser developed countries. Another type reaction has been that cotton is getting what it deserves-- that its subsidies are too high compared to other crops. Still another type reaction has been that other US crops could be next... a fear that this just may be the beginning. Another type reaction appears to be that this is just a bump in the road, not to fear, that this will be corrected in time.

What's next... According to US Trade Representative Robert Zoellick, the appeals process could take months or even years. According to sources I have seen and read, the US has until May 10th to request a review of the panel report and until June 3rd to submit final comments on the report. A final panel report must then be issued by June 18th. Any appeal must then be made within 30 days of this final ruling. This appeal must then be ruled on by a separate panel within 90 days. This would take us into mid-October. What happens after this is unknown at this point. It is purely conjecture on my part, but if the preliminary ruling stands, I would guess the US goal might be to keep this ruling tied up in litigation for the remainder of this farm bill.

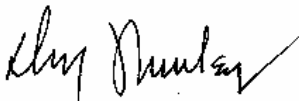
Observations and comments just for thought...

Regarding the claims that subsidies have contributed to increased US cotton production-- the only program payments to producers that are made on actual production are Loan Deficiency Payments (LDP's). Do LDP's effect cotton acreage and production decisions? Yes. Have LDP's contributed to higher US cotton acreage than would otherwise have been planted without them? Yes. Are LDP's part of the complaint? I don't know but if they are, this wouldn't bode well for other program crops either. Are such payments allowed under WTO? That seems to be the important question. Direct Payments (DP) (PFC under the 1996 farm bill) and Counter-Cyclical Payments (CCP) are tied to crop base, not actual production. Because these type payments are not based on actual production and have been a part of US farm programs since 1996 Freedom To Farm, could we safely assume they are not a problem? Have PFC and DCP payments contributed to increased cotton acreage? The only link one could possibly argue is that farmers might have an incentive to keep acreage planted to cotton regardless of the market price, to protect base and eligibility for payments.

Step 2 payments and export credit programs were apparently specifically mentioned in the complaint. Step 2 payments are apparently important to US export sales. Casual observation and comments (unresearched) concerning the market in recent years seems to suggest that sales may rise and fall with the availability and amount of payment. But many, many other factors also influence export sales including the value of the dollar and availability of and competition from other cottons around the world. It would seem to me that without Step 2, US and world prices would be (would need to be) lower rather than higher. From the standpoint of other countries, would this not do them more harm than good?

Regarding the claim that the US has garnered an unfair share of world exports-- I have been of the thinking that the increase in US exports has been largely due to the meltdown of the US domestic textile industry, not subsidies and credits. The decline of the US textile industry, it is said, has been due to cheap foreign labor, a strong US dollar, and relatively inexpensive imports of foreign manufactured textile products. As a matter of fact, the strong US dollar was one factor that contributed to the low prices of 2001 and 2002-- not just US production.

In all of this, the over-riding question would seem to be who can best meet the world's high demand for cotton and at what price? At conflict here are (1) US policies designed to allow prices to float as needed to meet supply and demand while still providing income protection for the farmer at low prices, (2) the agenda and objectives of other countries who see opportunities for expanded cotton production, and (3) the social agenda of less developed countries who see cotton production as a tool for improved economic development and sustainability. It is a complex problem. One thing we know (and we have first hand experience with this in Georgia and the rest of the southeast as well) is that you can't run a farm bill in opposition to trade policy-- peanuts proved that. Something will have to give-- the 2 will have to find common ground. I feel confident that US legislative, trade, agricultural, and commodity leaders will find ways to accomplish this.



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