Order Code RL32571

CRS Report for Congress

Brazil's WTO Case Against the U.S. Cotton Program

Updated October 16, 2007

Randy Schnepf
Specialist in Agricultural Policy
Resources, Science, and Industry Division

Prepared for Members and Committees of Congress

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Summary

In late 2002, Brazil initiated a World Trade Organization (WTO) dispute settlement case (DS267) against specific provisions of the U.S. cotton program. On September 8, 2004, a WTO dispute settlement (DS) panel ruled against the United States on several key issues in case DS267. The United States appealed the case to the WTO's Appellate Body (AB) which, on March 3, 2005, confirmed the earlier DS panel findings against U.S. cotton programs. Key findings include (1) U.S. domestic cotton subsidies have exceeded WTO commitments of the 1992 benchmark year, thereby losing the protection afforded by the "Peace Clause," which shielded them from substantive challenges; (2) the two major types of direct payments made under U.S. farm programs — Production Flexibility Contract payments of the 1996 Farm Act and the Direct Payments of the 2002 Farm Act — do not qualify for WTO exemptions from reduction commitments as fully decoupled income support and should therefore count against the "Peace Clause" limits; (3) Step-2 program payments are prohibited subsidies; (4) U.S. export credit guarantees are effectively export subsidies, making them subject to previously notified export subsidy commitments; and (5) U.S. domestic support measures that are "contingent on market prices" have resulted in excess cotton production and exports that, in turn, have caused low international prices and have resulted in "serious prejudice" to Brazil.

The AB recommended that the United States remove certain "prohibited subsidies" by July 21, 2005, and remove the adverse effects resulting from certain "actionable subsidies" by September 21, 2005. When the United States failed to meet these deadlines, Brazil claimed the right to retaliate against $3 billion in U.S. exports to Brazil based on the prohibited subsidies, and $1 billion based on the actionable subsidies. The United States objected to these retaliation amounts and requested WTO arbitration on the matter. However, in mid-2005 the United States and Brazil reached a procedural agreement to temporarily suspend both retaliation proceedings. The case was resumed on August 21, 2006, when Brazil submitted a request for a WTO compliance panel to review whether the United States had fully complied with the panel and AB rulings. A compliance panel was established on October 25, 2006. On October 15, 2007, the compliance panel released its final report to the United States and Brazilian governments that found, according to news reports, that the United States had not fully complied with the panel and AB rulings. The United States is expected to appeal the compliance panel's ruling. An unsuccessful appeal could necessitate further U.S. farm program changes or, if no further changes are forthcoming, clear the way for Brazil to request WTO authorization for retaliatory trade sanctions.

This report provides background, as well as details of the WTO dispute settlement case. It will be updated as events warrant. An abbreviated version of this report is available as CRS Report RS22187, *Brazil's WTO Case Against the U.S. Cotton Program: A Brief Overview.*

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Brazil's WTO Case Against The U.S. Cotton Program

Overview

This report provides a description and status report on Brazil's WTO challenge of certain aspects of the U.S. cotton program.[1] It begins with some brief background on the U.S. cotton sector. Then a timetable of the WTO dispute settlement process of the case is provided, followed by a description of both Brazil's specific charges against the U.S. cotton program and the WTO panel's ruling on those charges. Next, a description of U.S. compliance with the panel's ruling, Brazil's charges of inadequate compliance, and the WTO compliance dispute settlement process is covered. Finally, the report discusses the potential implications of this WTO case for both the U.S. cotton sector and Congress. An abbreviated version of this report is available as CRS Report RS22187, *Brazil's WTO Case Against the U.S. Cotton Program: A Brief Overview*.

Background on the U.S. Cotton Sector

The cotton industry is a major component of the U.S. agricultural sector. From 1994 to 2006, U.S. cash receipts from cotton production averaged $4.8 billion per year, while export sales averaged over $2.9 billion. Cotton is grown across the southern tier of states stretching from Virginia down through the Carolinas and into Georgia, then westward through a belt of contiguous states stretching to California. Texas is the largest cotton-producing state, accounting for an average of 26% of U.S. production since 1990. In 2002, 17 states reported cotton production valued at over $20 million.

The United States is the second-largest producer of cotton in the world. In recent years, the United States has been exporting an increasing share of its annual production, due in large part to a decline in domestic mill use. (See **Figure 1**.) U.S. exports as a share of production have averaged 59% since 2001, up from a 42% average during the early 1990s.

The United States is the world's largest cotton exporter. Since 2001, U.S. exports have accounted for nearly 40% of world cotton trade. U.S. prominence in global markets coupled with large U.S. subsidy levels have directed much international attention to U.S. cotton program outlays in recent years.

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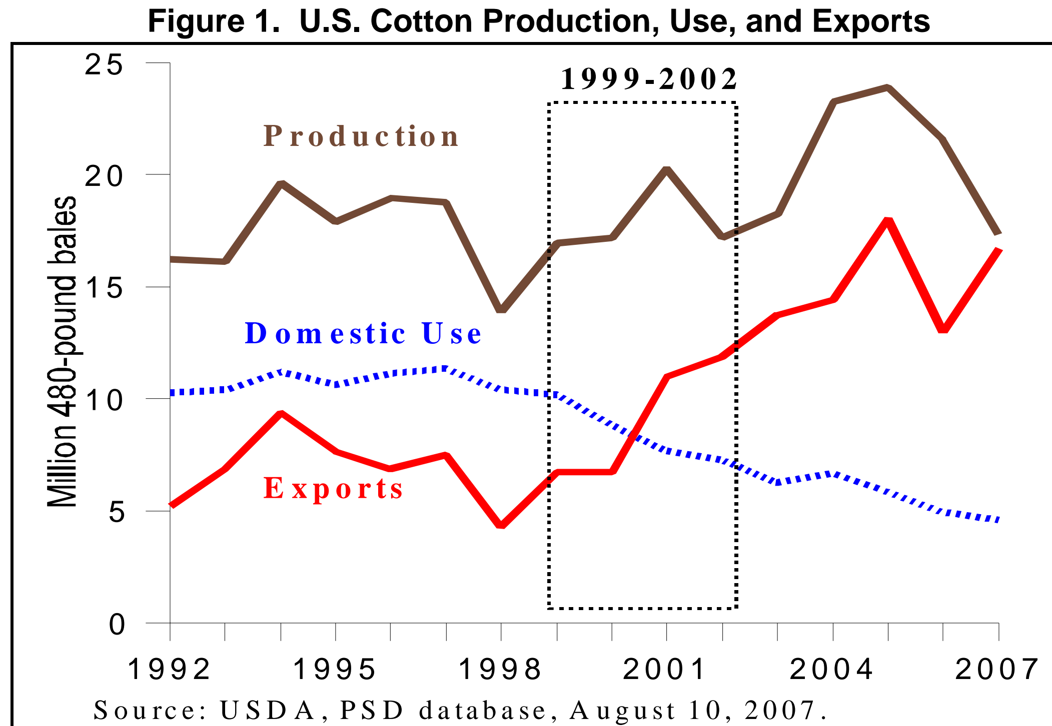
[1] Official WTO documents as cited in Table 2 and throughout this report are available at [http://docsonline.wto.org/] under a simple search using the specific "document symbol" cited, e.g., WT/DS267/1.

Cotton is one of the principal U.S. program crops, along with wheat, rice, feed grains, soybeans, and peanuts. Qualifying U.S. cotton producers are eligible for direct payments, counter-cyclical payments, loan deficiency payments, Step-2 payments, and other program benefits.[2] Since FY2000, U.S. farm subsidies for cotton production averaged $3.1 billion per year, while the harvest-time value of production has averaged $4.2 billion (**Table 1**).

Figure 1. U.S. Cotton Production, Use, and Exports



Source: USDA, PSD database, August 10, 2007.

Sequence of Events in WTO Case DS267

In 2002, Brazil — a major cotton export competitor — expressed its growing concerns about U.S. cotton subsidies by initiating a WTO dispute settlement case (DS267) against certain features of the U.S. cotton program. Once initiated, a dispute settlement case follows a sequence of events designed to produce resolution of the dispute within a 12-15 month time frame. However, the WTO dispute settlement (DS) process that reviewed Brazil's charges against the U.S. cotton program has extended well beyond the hypothetical 15-month time frame. In this particular case, the initial WTO panel review took 18 months from the establishment of the panel to its final ruling. Furthermore, substantial additional time has since been added to the dispute settlement process — first, for an Appellate Body review of the initial ruling on appeal and second, for a WTO compliance panel review followed by a dispute over U.S. compliance with the initial panel's ruling. The compliance panel review is still ongoing, with a final report expected sometime in October 2007; however, the DS process could potentially be extended further into 2008 by a likely appeal of the compliance panel's ruling. See **Table 2** for a timeline of the dispute settlement case.

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[2] For more details on U.S. cotton program operations, see CRS Report RL32442, *Cotton Production and Support in the United States*, June 24, 2004.

Table 1. U.S. Upland Cotton Program Outlays and Harvest-Time Value of Production, FY1991-FY2008[a]

Fiscal year[b]	Total Outlays[c]	Value of production[d]
	$ million	$ million
1991	382	4,894
1992	1,443	4,728
1993	2,239	4,082
1994	1,539	4,367
1995	99	6,631
1996	685	6,358
1997	561	6,137
1998	1,132	5,709
1999	1,882	3,924
2000	3,809	3,534
2001	1,868	4,073
2002	3,307	2,834
2003	2,889	3,497
2004	1,372	5,266
2005	4,245	4,540
2006	3,982	5,319
2007[e]	2,639	4,801
Sum: 1991-2007	36,501	80,692
Average: 1991-1999	1,274	5,203
Average: 2000-2007	3,129	4,233

Source: USDA, Farm Service Agency, Budget Division, *History of Budgetary Expenditures of the Commodity Credit Corporation*, Books 3 (April 9, 2001) and 4 (July 15, 2003), available at [http://www.fsa.usda.gov/dam/bud/bud1.htm].

[a] Data are for program outlays within the reported fiscal year. Payments may be specific to cotton from several different crop or marketing years.

[b] The fiscal year starts Oct. 1 and ends Sept. 30 of the following year. Fiscal year identification is with the second year. For example, FY1993 starts Oct. 1, 1992, and runs through Sept. 30, 1993.

[c] Includes deficiency payments, production flexibility contract payments, loan deficiency payments, user market payments (Step 2), marketing loss payments, outlays from general loan operations, and other miscellaneous payments. Payments exclude loan repayment write-offs (otherwise referred to as producer marketing loan gains) and certificate sales proceeds/losses, both of which are treated as non-cash transactions.

[d] Production is valued at harvest-time prices. Each production value is for the crop harvested during the crop year preceding the designated fiscal year.

[e] USDA estimate, Table 35, "CCC Net Outlays by Commodity and Function," Sept. 11, 2007, available at [http://www.fsa.usda.gov/dam/bud/bud1.htm].

Table 2. Timeline: U.S.-Brazil WTO Dispute Settlement Case 267

Date	Event
Sept. 27, 2002	Brazil made a formal "request for consultations" with the United States (WT/DS267/1).
Oct. 2002 to Jan. 2003	Brazil and the United States held three consultations to discuss the dispute over U.S. cotton subsidies. The consultations were unsuccessful.
Feb. 7, 2003	Brazil's first request for the establishment of a dispute panel to rule on its complaint is vetoed by the United States (WT/DS267/7).
Mar. 18, 2003	Upon Brazil's second request, the WTO's Dispute Settlement Body (DSB) established a panel (WT/DS267/15).
May 19, 2003	Appointment of the panelists by the WTO Director-General. Once formed, a panel normally has six months to hold hearings and gather testimony before issuing its final report to both parties.
July 22, 2003	First meeting with the DSB panel. The panel decides to review the peace clause issue and Brazil's challenge to U.S. cotton subsidies separately.
Sept. 2003	The panel reversed an earlier procedural decision and stated that it would decide both the peace clause issue and Brazil's challenge to U.S. cotton subsidies together.
Nov. 17, 2003	The panel chairman informed the DSB that the panel would not be able to complete its work in six months due to the complexity of the matter. An extension was announced (WT/DS267/16).
Apr. 26, 2004	The panel's interim report is released confidentially to the two parties. Both parties review the interim report and submit written comments by May 10, at which time they have three additional weeks to review each other's comments and respond. Although the report was released confidentially, news reports suggested at least a partial finding against the United States on each of the five major claims.[3]
June 18, 2004	The panel's final report is released confidentially to the two parties. News reports suggested that the final ruling varied little from the interim ruling against the United States.[4]
Sept. 8, 2004	After translation into English, French, and Portuguese, the final report is delivered to the WTO Dispute Settlement Body (DSB), as well as to the public (WT/DS267/R).

[3] "Brazil Wins Key Points in Interim WTO Panel on U.S. Cotton Subsidies," *Inside U.S. Trade*, April 30, 2004; "WTO Panel Backs Brazil in Complaint Against U.S. Over Cotton Subsidies," *International Trade Reporter*, Vol. 21, No. 18, April 29, 2004; and "WTO Panel Reportedly Rules Direct Payments are Trade Distorting and Thus 'Amber Box,'" AgWeb.com, April 30, 2004.

[4] "WTO Ruling Against U.S. Cotton Subsidies is Not Limited to Cotton," AgWeb.com, June 29, 2004; and "WTO Issues Final Ruling Condemning U.S. Cotton Subsidies; U.S. Plans Appeal," *International Trade Reporter*, Vol. 21, No. 26, June 24, 2004.

Date	Event
Oct. 18, 2004	The United States notified its intention to appeal 14 specific points of the final report to the Appellate Body. The 14 points identify certain issues of law covered in the panel's final report and certain legal interpretations developed by the panel in the dispute. An appeal cannot reexamine existing evidence or examine new evidence (WT/DS267/17).
Nov. 16, 2004	Several additional countries filed a third participant's submission, while others notified their intention to appear at the oral hearing.
Dec. 10, 2004	Due to the extent and complexity of issues under review, both the United States and Brazil agreed to an extension to March 3, 2005, for circulation of the Appellate Body's (AB's) final report (WT/DS267/18).
Mar. 3, 2005	The AB issued its report upholding most of the panel's rulings (WT/DS267/ABR). Deadlines of July 1, 2005 for removal of prohibited subsidies, and Sept. 21, 2005, for removal of prejudicial effects from actionable subsidies are announced by AB.
Mar. 21, 2005	The DSB adopted the AB and panel reports, thus initiating a sequence of compliance deadlines (WT/DS267/20).
Apr. 20, 2005	The United States announced to the DSB that it intended to implement the recommendations and rulings of the DSB.
June 30, 2005	USDA announced temporary fix for its export credit guarantee programs, including adoption of risk-based fee structure for GSM 102 and cessation of use of GSM 103 program. In addition, USDA sent proposed legislation to Congress to repeal the Step 2 cotton program.
July 1, 2005	AB deadline for U.S. removal of prohibited subsidies expires.
July 4, 2005	Brazil requested authorization from WTO to impose $3 billion in retaliatory measures against prohibited U.S. subsidies (WT/DS267/21).
July 5, 2005	USDA proposed statutory changes be made by Congress: remove 1% fee cap on GSM 102 program and terminate GSM 103 program.
July 5, 2005	United States objected to the amount of Brazil's proposed sanctions on the prohibited subsidies and requested WTO arbitration (WT/DS267/23).
July 14, 2005	The DSB assigned role of arbitration on the prohibited-subsidy sanctions to the original panel (WT/DS267/24).
Aug. 17, 2005	Brazil and United States reached procedural agreement to temporarily suspend arbitration proceedings concerning the prohibited subsidies (WT/DS267/25).
Sept. 1, 2005	AB deadline for U.S. removal of prejudicial effects from actionable subsidies expired.
Oct. 6, 2005	Brazil requested authorization from WTO to impose $1 billion in retaliatory measures against actionable U.S. subsidies to offset their adverse effects (WT/DS267/26).

Date	Event
Oct. 17, 2005	United States objected to the amount of Brazil's proposed sanctions on the actionable subsidies and requested WTO arbitration (WT/DS267/27).
Oct. 18, 2005	The DSB assigned role of arbitration on the actionable-subsidy sanctions to the original panel (WT/DS267/28).
Nov. 21, 2005	Brazil and United States reached procedural agreement to temporarily suspend arbitration proceedings concerning the actionable subsidies (WT/DS267/29).
July 24, 2006	Doha round of WTO trade negotiations suspended indefinitely.[5]
Aug. 1, 2006	Step 2 cotton program eliminated (Sec. 1103, P.L. 109-171; the Deficit Reduction Act of 2005).
Aug. 21, 2006	Brazil requested the establishment of a WTO compliance panel to review whether the United States had fully complied with the AB's ruling of March 3, 2005 (WT/DS267/30).
Sept. 28, 2006	The DSB agreed to establish a panel (WT/DS267/31). The panel members were announced by the WTO's Director-General on Oct. 25, 2006.
Jan. 9, 2007	The DSB announced that, because of the particular circumstances of the case, the compliance panel would not complete its work before July 2007.
July 27, 2007	The WTO compliance panel issued its confidential interim ruling to Brazil and the United States. News reports suggest a ruling that the United States has not fully complied with the March 2005 ruling.[6]

Source: Compiled by CRS from official WTO documents and news sources as cited.

[5] For more information, see CRS Report RL33144 *WTO Doha Round: The Agricultural Negotiations*, by Charles Hanrahan and Randy Schnepf.

[6] For example, see *Financial Times*, "Brazil Claims WTO Cotton Victory," July 27, 2007.

Brazil's WTO Case Against The U.S. Cotton Program

Brazil's case was broadly written and touched on almost every aspect of U.S. commodity programs, although the focus has been on the six principal claims described below along with the WTO dispute settlement panel finding (of September 8, 2004) and Appellate Body (AB) ruling (of March 3, 2005).[7]

Claim 1: Peace Clause Violation. Brazil claimed that the United States is no longer exempt from WTO dispute proceedings under the so-called "peace clause" (Article 13) of the WTO's Agreement on Agriculture (AA) because U.S. domestic and export subsidies to its cotton sector are in excess of its WTO commitments.[8] Prior to its expiry in January of 2004, Article 13 exempted domestic support measures that complied with the AA's requirements from being challenged as illegal subsidies through dispute settlement proceedings, as long as the level of support for a commodity remained at or below the benchmark 1992 marketing year (MY) levels.[9] Brazil argued that U.S. cotton subsidies were about $2 billion in MY1992 compared with over $4 billion in MY2001. Therefore, Brazil argued that the United States was no longer in compliance with the requisite conditions and could no longer seek protection under the WTO's peace clause rule.

In response, U.S. trade officials argued that WTO members agreed to the peace clause recognizing that agricultural subsidies could not be eliminated immediately and needed, under certain conditions, to be exempted from the Subsidies and Countervailing Measures (SCM) Agreement and GATT 1994 subsidies disciplines. As a result, U.S. officials argued that the words "exempt from actions" as used in Article 13 of the AA were of overarching importance and precluded not only the "taking of legal steps to ... obtain a remedy," as Brazil has argued, but also the "taking of legal steps to establish a claim."[10] Furthermore, U.S. trade officials argued that the immunity granted by the peace clause was still important, since even if a country was no longer in compliance with the peace clause, it was incumbent on the complaining party to prove there had been injury. (See "Claim 5," below.)

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[7] Ministry of Foreign Affairs [Ministério das Relações Exteriores], Brasilia; "Brazil-U.S.A. Dispute on Subsidies on Upland Cotton," translation from the original in Portuguese, Nota nº 248-18/06/2004; Distribuição 22 e 23.

[8] WTO, *The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations*, Cambridge Univ. Press, ©World Trade Organization 1999; hereafter referred to as *WTO Legal Texts*. Text of the Agreement on Agriculture is available online at [http://www.wto.org/english/docs_e/legal_e/14-ag.pdf].

[9] USDA reports commodity program outlays on a fiscal year (FY) basis. (See **Table 1**.) However, marketing year data, not fiscal year, must be used in the WTO case. The U.S. cotton marketing year starts August 1 and ends July 31 of the following year, but identifies with the first year, such that MY1992 starts August 1, 1992, and ends July 31, 1993. The principal period in question, MY1999-MY2002, corresponds roughly with FY2000-FY2003.

[10] *United States — Subsidies on Upland Cotton*, WT/DS267, "Initial Brief of the United States of America on the Question Posed by the Panel," June 13, 2003; available from the USTR website at [http://www.ustr.gov/assets/Trade_Agreements/Monitoring_Enforcement/Dispute_Settlement/WTO/Dispute_Settlement_Listings/asset_upload_file376_5598.pdf].

Finding 1. The panel found (and was upheld by the AB) that Brazil had successfully discharged its burden to show that U.S. domestic cotton support measures during MY1999-MY2002 (which averaged $3.28 billion) were in excess of WTO commitments (of $2.0 billion) during MY1992. (See **Table 3**.) As a result, U.S. domestic cotton support measures lost the protection afforded by the "Peace Clause," which had shielded them from substantive challenges in the past. This occurred in part because, under Finding 2, Production Flexibility Contract and Direct Payment outlays were included with other commodity program outlays and evaluated against "peace clause" limits.

Table 3. Comparison of U.S. Domestic Cotton Support in Accordance with Article 13(b)(ii)

$ million	MY1992	MY1999	MY2000	MY2001	MY2002
Total	$ 2,012.7	$ 3,404.4	$ 2,429.3	$ 4,144.2	$ 3,140.3

Source: *United States — Subsidies on Upland Cotton*, "Report of the Panel," WTO, WT/DS267/R, Sept. 8, 2004; p. 157.

Claim 2: U.S. Direct Payments Do Not Qualify for Exemption from Reduction Commitments as Decoupled Income Support. Brazil claimed that two types of U.S. payments — Production Flexibility Contract (PFC) payments made under the 1996 farm bill and Direct Payments (DP) made under the 2002 farm bill — failed to fully meet the conditions for decoupled income support in Annex 2 of the Agreement on Agriculture and should therefore be counted against the U.S. "Peace Clause" domestic support benchmark limit.

The United States considers both PFC and DP programs to be consistent with WTO language for exempt domestic support that has "no, or at most minimal, trade-distorting effects or effects on production."[11] As a result, the United States notifies both the PFC and DP outlays as "green box" where they are not subject to any limits. Furthermore, the United States argued strongly against including such "minimally distorting, non-commodity specific" payments in evaluating whether the United States has met or exceeded its "peace clause" limits.

Finding 2. The panel found (and was upheld by the AB) that U.S. payments made under the PFC and DP programs, because of the prohibition on planting fruits, vegetables, and wild rice on covered program acreage,[12] do not qualify for the WTO's green box category of domestic spending. (The green box contains only non-distorting program payments and is not subject to any limit). Instead, they should be counted as domestic subsidies directly affecting cotton production (i.e., distorting) and be included with other commodity program outlays to evaluate whether the United States has met or exceeded its "peace clause" limits.

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[11] WTO, "Annex 2 — Domestic Support: The Basis for Exemption from the Reduction Commitments," Agreement on Agriculture, *WTO Legal Texts*, p. 48.

[12] For more information on these restrictions see USDA, Farm Service Agency, Fact Sheet, *Direct and Counter-Cyclical Payment Program Wild Rice, Fruit, and Vegetable Provisions*, February 2003, at [http://www.fsa.usda.gov/pas/publications/facts/html/fav03.htm].

Claim 3: The Step-2 Program Functions as an Export Subsidy. Brazil argued that Step-2 payments made under the U.S. cotton program function as export subsidies and are inconsistent with U.S. WTO obligations regarding export subsidies as specified under the SCM Agreement.

Step-2 payments are part of special cotton marketing provisions authorized under U.S. farm program legislation to keep U.S. upland cotton competitive on the world market. Step-2 payments are made to exporters and domestic mill users to compensate them for their purchase of higher priced U.S. upland cotton. Under the 2002 Farm Act, the Step-2 payment rate for the 2002-2005 marketing years is calculated as the difference between the price of U.S. upland cotton, delivered c.i.f. (cost, insurance, freight) in Northern Europe and the average of the five lowest prices of upland cotton delivered c.i.f. Northern Europe from any source.[13]

The United States argued that Step-2 payments are part of its domestic support program since they are targeted to domestic cotton users as well as exporters. As a result, Step-2 payments are notified to the WTO as "amber" box (trade-distorting) domestic support payments and not as export subsidies. Consequently, U.S. trade officials contend that Step-2 payments are not subject to any limitations placed on export subsidies.

Finding 3. In its finding, the panel considered Step-2 program payments to eligible exporters separately from payments to domestic users.

- Payments to exporters were found to be "contingent upon export performance" and therefore qualified as prohibited export subsidies in violation of WTO commitments.
- Payments to domestic users were found to be "contingent on the use of domestic over imported goods" and therefore qualified as prohibited import substitution subsidies.

The DS panel finding was upheld by the Appellate Body.

Claim 4: U.S. Export Credit Guarantees Function as Export Subsidies. Brazil claimed that the favorable terms (i.e., the interest rate and time period that countries have to pay back the financing) provided under U.S. export credit guarantee programs — GSM102, GSM103, and the Supplier Credit Guarantee Program (SCGP)[14] — are effectively export subsidies inconsistent with the WTO's

[13] Only prices for Middling (M) 1-3/32-inch upland cotton are used in the calculation. Also, certain price triggers must be met and held for a specified period of time before payments can be made. For information on the Step-2 program and other U.S. cotton program features, see USDA, ERS, "Cotton Briefing Room,"at [http://www.ers.usda.gov/Briefing/Cotton/].

[14] For information on U.S. export credit programs, see USDA, Foreign Agricultural Service (FAS), "Export Credit Guarantee Programs," at [http://www.fas.usda.gov/excredits/default.htm].

AA and SCM Agreements. Further, the subsidy effects of export credit guarantees apply not only to cotton, but to other eligible commodities.[15]

U.S. trade officials argued that the U.S. export credit guarantee programs are consistent with WTO obligations. Furthermore, the United States asserted that Article 10.2 of the AA reflected the deferral of disciplines on export credit guarantee programs contemplated by WTO members to the next WTO multilateral negotiating round — the Doha Round.

Finding 4. The panel found (and was upheld by the AB) that U.S. export credit guarantees effectively functioned as export subsidies because the financial benefits returned by these programs failed to cover their long-run operating cost.[16] Furthermore, the panel found that this applies, not just to cotton, but to all commodities that benefit from U.S. commodity support programs and receive export credit guarantees. As a result, export credit guarantees for any recipient commodity are subject to previously scheduled export subsidy commitments for that commodity. This refers to those U.S. export subsidies under the Export Enhancement Program (EEP) and the Dairy Export Incentive Program (DEIP).[17] Under these criteria, export credit guarantees benefits extended to cotton and other "unscheduled" commodities (that are supported under U.S. agricultural programs) are found to be in violation of previous WTO commitments.[18] With respect to "scheduled" commodities, export credit guarantees extended to U.S. rice exports were found to be in violation of previous EEP volume commitments.

The panel found (and was upheld by the AB) that "unscheduled" commodities not supported under U.S. agricultural programs, as well as scheduled agricultural products that remain within WTO commitments are exempt from actions under this dispute settlement case.

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[15] For a list of commodities eligible for export credit guarantees see USDA, Foreign Agricultural Service, *USDA Amends Commodity Eligibility under Credit Guarantee Programs*, News Release, September 24, 2002; available at [http://www.fas.usda.gov/scriptsw/PressRelease/pressrel_dout.asp?Entry=valid&PrNum=0346-02].

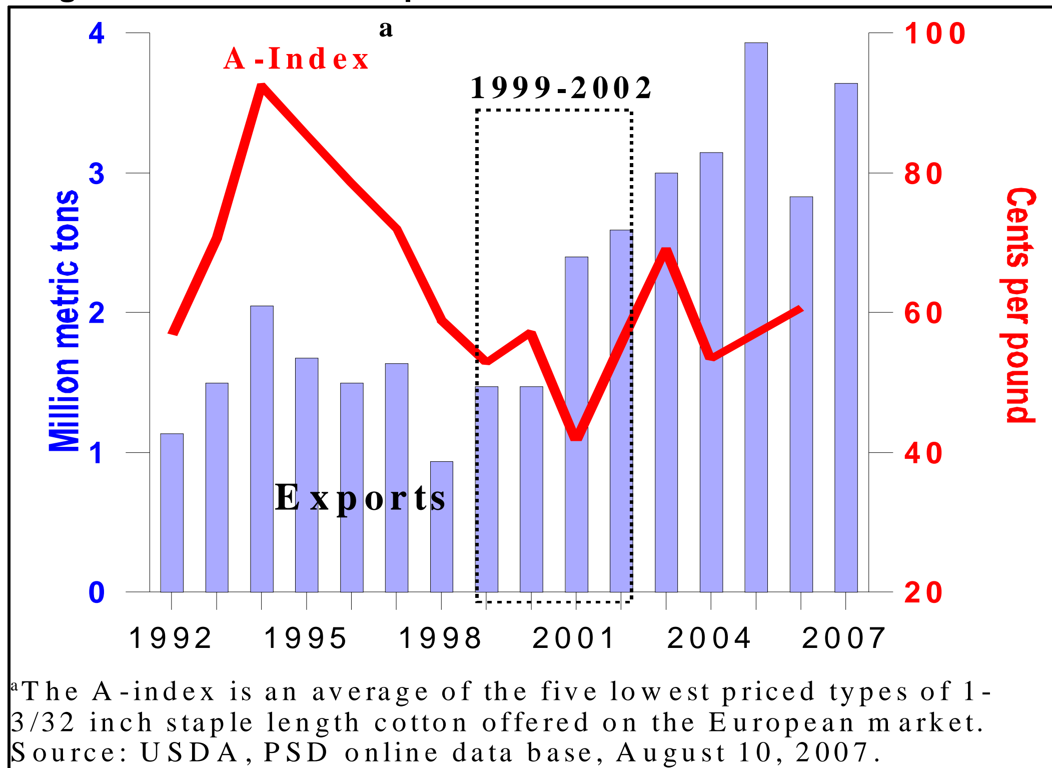
[16] Found to violate Annex I(j) of the SCM, *WTO Legal Texts*, p. 267, which identifies as an export subsidy, "The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes."

[17] The United States has scheduled export subsidy reduction commitments for the following thirteen commodities: wheat, coarse grains, rice, vegetable oils, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, pigmeat, poultry meat, live dairy cattle, and eggs. For more information on the EEP and DEIP programs, see CRS Report RL33553, *Agricultural Export and Food Aid Programs*.

[18] Those agricultural products which did not receive U.S. farm program support payments, but whose exports were otherwise assisted by export credit guarantee program are excluded from this case; WT/DS267/R, p. 348(d)(ii).

Claim 5: U.S. Subsidies Have Caused "Serious Prejudice". Brazil argued that domestic farm subsidies provided to U.S. cotton growers contributed to significant overproduction and resulted in a surge in U.S. cotton exports, particularly during the 1999-2002 marketing years, when unusually large outlays were made under provisions of the U.S. cotton program (see **Table 1** and **Figure 1**). Brazil claimed that the resultant rise in U.S. exports led to three market conditions, each of which contributed to serious injury to Brazilian cotton exporters: (i) by increasing the U.S. share of the world upland cotton market; (ii) by displacing or impeding Brazilian upland cotton sales in third-country markets; and (iii) by contributing to a steep decline in world cotton prices (see **Figures 2 and 3**).[19]

Figure 2. U.S. Cotton Exports and International Cotton Price Index



[a] The A-index is an average of the five lowest priced types of 1-3/32 inch staple length cotton offered on the European market.
Source: USDA, PSD online data base, August 10, 2007.

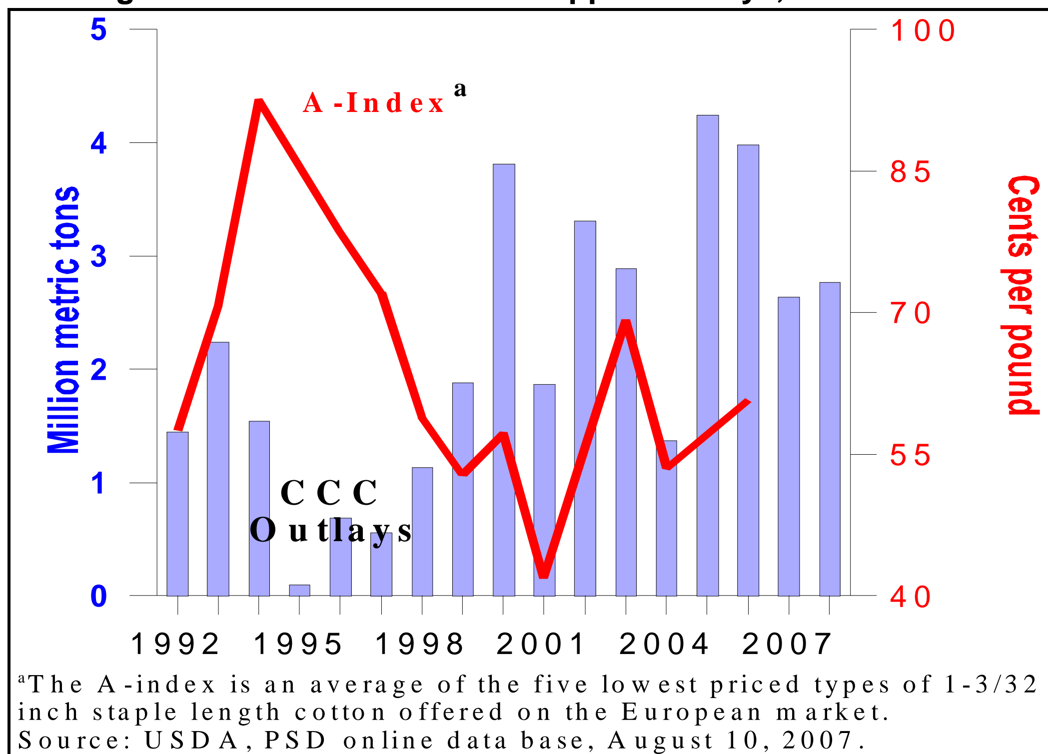
In particular, Brazil claims that injury to its economy due to low cotton prices, measured as the sum of individual negative impacts on income, foreign trade revenue, fiscal revenues, related services (transportation and ginning), and employment, exceeded $600 million in 2001 alone. Brazil asserts that injury under each of these three circumstances are in violation of the SCM Agreement.[20] In

[19] Articles 5(c) and 6.3(b) of the Agreement on Subsidies and Countervailing Measures (SCM) deal with subsidies that result in adverse effects in other WTO-member countries. Brazil specifically identified Argentina, Bangladesh, Colombia, Germany, India, Indonesia, Italy, Portugal, Philippines, Slovenia, South Africa, South Korea, Switzerland, Thailand, and Turkey as the relevant third-country markets. WTO "Communication from Brazil," WT/DS267/9, March 21, 2003.

[20] Text of the Agreement on SCM is available online at [http://www.wto.org/english/docs_e/

addition, Brazil argued that these same programs would be harmful (i.e., threatened serious prejudice) in future years.

Figure 3. USDA CCC Cotton Support Outlays, 1992 to 2007



[a]The A-index is an average of the five lowest priced types of 1-3/32 inch staple length cotton offered on the European market.
Source: USDA, PSD online data base, August 10, 2007.

U.S. trade officials argued that the subsidies provided to U.S. cotton growers have been within the allowable WTO limits and are consistent with U.S. WTO obligations. Furthermore, they argued that the decline in U.S. domestic use (due to declining U.S. competitiveness in textile and apparel production), rather than government support program outlays, contributed to larger U.S. raw cotton exports. In addition, they contended that international market forces — including weakness in world demand for cotton due to competing, low-priced synthetic fibers, and weak world economic growth — have played a larger role in determining the generally weak price level during the period in question, rather than U.S. export levels. For example, see **Figure 4** for a visibly strong correlation between China cotton imports and the international cotton "A-index."

In evaluating this particular claim, the DS panel separated U.S. cotton support programs into two groups: those that are directly contingent on market price levels (i.e., loan deficiency payments, marketing loss assistance payments, counter-cyclical payments, and Step-2 payments), and those that are not (i.e., PFC and Direct Payments, and the federal crop insurance program).

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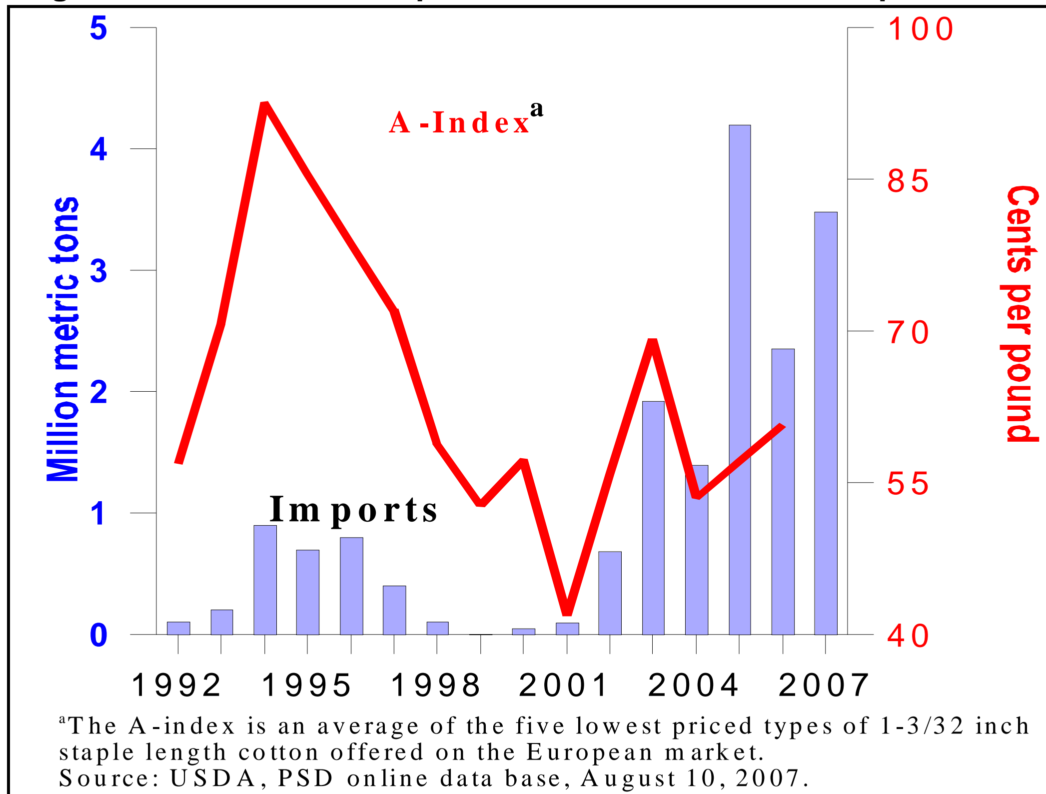
[20] (...continued)
legal_e/24-scm.pdf].

Figure 4. China cotton imports and international cotton price index



[a]The A-index is an average of the five lowest priced types of 1-3/32 inch staple length cotton offered on the European market.
Source: USDA, PSD online data base, August 10, 2007.

Finding 5. The panel found (and was upheld by the AB) that U.S. domestic support measures that are directly contingent on market price levels caused serious prejudice in terms of market price suppression for the period 1999 to 2002. However, U.S. domestic support measures that are not contingent on market price levels were not included in this finding as the panel could not find enough of a connection between the direct payments program and cotton planting decisions to declare the direct payments program a serious factor in price suppression.[21]

The panel also did not find in favor of Brazil's alleged serious prejudice in terms of an effect on international market share. Article 6.3 of the SCM lists several factors indicating serious prejudice; the panel only had to find one of the factors in violation to rule in Brazil's favor on the claim of serious prejudice during the 1999 to 2002 period.

With respect to Brazil's claim of a threat of serious prejudice going forward (i.e., 2003 to 2007 — the remaining life of the 2002 farm act), the panel stated in its final report that those "prohibited" subsidies that cause the serious prejudice during the 1999-to-2002 period — namely, user marketing (Step-2) payments to exporters and domestic users; and export credit guarantees in respect of certain products under the GSM 102, GSM 103, and SCGP programs — must be withdrawn "without delay"

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[21] WT/DS267/R, paragraph 7.1307, p. 307.

pursuant to Article 4.7 of the SCM Agreement.[22] According to the panel, required withdrawal of the prohibited subsidies, within the time frame set by the panel, would curtail the future threat posed by U.S. cotton support programs. As a result, the panel stated that "...it is not necessary or appropriate to address Brazil's claims of threat of serious prejudice..."[23]

Claim 6: FSC-ETI Act of 2000 Acts as an Export Subsidy to Upland Cotton. Brazil claimed that the Foreign Sales Corporation Repeal and Extraterritorial Income Act of 2000 (ETI Act of 2000), by eliminating tax liabilities for U.S. upland cotton exporters who sell to foreign markets, constitutes an export subsidy and is inconsistent with U.S. export subsidy commitments for cotton.

The United States asserted throughout the proceedings that Brazil failed to make any specific case with respect to the ETI Act of 2000 and U.S. upland cotton exports.

Finding 6. The panel concurred with the United States (and was upheld by the AB) in stating that Brazil failed to present any new arguments or evidence concerning effects upon upland cotton, but instead simply repeated the arguments that the European Union made in its WTO dispute settlement case with the United States (DS108).[24] As a result, the panel declined to further examine Brazil's claims on this particular issue.

Panel Recommendations

The initial panel's final ruling was released publicly on September 8, 2004. The following month (October 18, 2004) the United States notified the WTO of its intent to appeal the panel's ruling. A WTO Appellate Body (AB) reviewed the legality of the case and issued its final report on March 3, 2005, upholding most of the initial panel's rulings. The policy recommendations that emerged from the panel and AB rulings are described below.

Prohibited Subsidies. The AB recommends that the United States withdraw those support programs identified as prohibited subsidies within six months of the date of adoption of the panel report by the Dispute Settlement Body (DSB) or by July 1, 2005 (whichever is earlier).[25] Since the DSB adopted the AB and panel reports on March 21, 2005, the relevant deadline for withdrawal was July 1, 2005. The list of prohibited subsidies subject to withdrawal "without delay" includes:

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[22] *Report of the Panel*, "United States — Subsidies on Upland Cotton," WTO, WT/DS267/R, para 7.1503, September 8, 2004, p. 345; hereafter referred to as WTO, WT/DS267/R.

[23] Ibid.

[24] For more information on DS108, see CRS Report RL32014, *WTO Dispute Settlement: Status of U.S. Compliance in Pending Cases* by Jeanne Grimmett.

[25] Done in accordance with SCM, Article 4.7.

Prohibited Export Subsidies.

- export credit guarantees under GSM 102, GSM 103, and SCGP that assist exports of upland cotton and other unscheduled agricultural products that are supported under government agricultural support programs;
- export credit guarantees under GSM 102, GSM 103, and SCGP that assist exports of one scheduled agricultural product (rice), but in excess of the scheduled volume; and
- Step-2 program payments to exporters of upland cotton.

Prohibited Import Substitution Subsidy.

- Step-2 payments to domestic users of upland cotton.

In contrast, unscheduled agricultural products not supported under government agricultural support programs and scheduled agricultural product exports that remain within their schedules were judged not to circumvent U.S. export commitments and therefore were not subject to trade remedy actions in this case.

Actionable Subsidies. The panel recommended that the United States take appropriate steps by September 21, 2005, to remove the adverse effects or to withdraw those U.S. subsidy measures singled out as price-contingent — marketing loan provisions, Step-2 payments, and CCP payments. These subsidies were identified as "actionable" subsidies that contributed to serious prejudice to the interests of Brazil during the marketing years 1999-2002.

It is noteworthy that the actionable subsidies remedy is dealing with serious prejudice and injury that occurred during a historical time period and not future prejudice or injury. In support of this concept, the panel stated (in its original ruling on the "threat of serious prejudice" by actionable subsidies) that U.S. compliance with recommendations on prohibited subsidies — i.e., the Step-2 provisions and export credit guarantees — could so significantly transform the basket of measures currently in question that it is not necessary or appropriate to address Brazil's claims of threat of serious prejudice.[26] This appeared to leave open the possibility that removal of the prohibited subsidies may resolve the dispute under the actionable subsidies recommendation.

Implementation Phase[27]

Following is a discussion of how the implementation phase could potentially unfold in accordance with WTO rules, how actual implementation has unfolded to date, and the nature and effects of U.S. compliance decisions. A summary of current U.S. compliance actions and their implications for the U.S. cotton sector are covered

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[26] WTO, WT/DS267/R, para. 7.1503, p. 354.

[27] For details, see *Understanding the WTO: Settling Disputes*, "The Case Has Been Decided, What Next?" at [http://www.wto.org/english/thewto_e/whatis_e/tif_e/disp1_e.htm].

in CRS Report RS22187, *Brazil's WTO Case Against the U.S. Cotton Program: A Brief Overview.*

WTO Rules Suggest Two Potential Time Tracks. In accordance with WTO rules, the evolution of the implementation phase depends on how both parties choose to respond to the different sequence of events as they unfold. In addition to the potential time tracks described below, the implementation phase also provides opportunities for the disputing parties to mutually resolve the dispute. If the United States were to fail to comply, Brazil could (upon visible evidence of noncompliance) request negotiations with the United States to determine mutually acceptable compensation (e.g., tariff reductions in areas of particular interest). Furthermore, if Brazil does not want to press ahead full force with imposing sanctions, there is considerable opportunity to delay compliance steps.

The time track for U.S. compliance with panel and AB recommendations may diverge depending on whether the United States chooses to respond separately to the rulings on prohibited subsidies and actionable subsidies. This is because prohibited subsidies are given expedited treatment under SCM, Article 4.12, which states that, "except for time-periods specifically prescribed in [SCM, Article 4], time-periods applicable under the DSU for the conduct of such disputes shall be half the time prescribed therein."

Prohibited Subsidies Potential Time Track. As a result of their expedited treatment, the AB recommended that the United States remove the prohibited export subsidies by July 1, 2005. Within 15 days after the AB and panel reports were adopted by the DSB (done on March 21, 2005),[28] the United States was expected to present an implementation plan to the DSB, although precedence suggests that such a plan could be as minimal as stating intentions to work with Congress to bring U.S. policies into compliance. This was indeed the case when, on April 20, the U.S. representative to the WTO announced that the United States intended to implement the recommendations and rulings of the DSB in a manner that respected U.S. WTO obligations.[29] The representative noted, however, that determining acceptable options would take a reasonable period of time and requested that Brazil be willing to consult on the potential timetable.

If, 10 days after the designated period (July 1, 2005) expires, no satisfactory compensation is agreed to, the complaining side (Brazil) may ask the DSB for permission to impose limited trade sanctions against the United States.[30] The trade sanctions are limited to a value equivalent to no more than the level of nullification

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[28] Normally a 30-day period is given to respond (DSU, Article 21.3); however, this is halved under SCM, Article 4.12.

[29] U.S. Mission to the United Nations in Geneva, Press Release, "Statements by the U.S. Representative at the meeting of the WTO Dispute Settlement Body," April 20, 2005.

[30] Normally a 20-day period is given (DSU, Article 22.2); however, for disputes involving prohibited subsidies the prescribed time is halved (SCM, Article 4.12).

or impairment of benefits. The DSB must grant this authorization within 15 days of expiry of the "reasonable" time period unless a consensus exists against the request.[31]

If the United States objects to the amount proposed by Brazil, the level of suspension would be arbitrated (by the original panel if available). Arbitration shall be completed within 30 days after the date of expiry of the designated period (July 1, 2005).[32] No trade sanctions are to be imposed during the arbitration period.

Once armed with the authority to impose trade sanctions, Brazil could still choose to wait. A precedent for this occurred under the WTO Dispute Settlement case (DS108) involving the U.S. Foreign Sales Corporation Statute. Under DS108, the European Communities (EC) requested and received authorization to impose retaliatory measures against the United States on May 7, 2003.[33] However, the EC refrained from immediate action, stating that it would review U.S. actions for a period of time before proceeding. The EC eventually began imposing additional duties on U.S. products in March 2004.

Actionable Subsidies Potential Time Track. In contrast to the July 1, 2005, deadline, the removal of actionable subsidies is subject to a six-month period starting on the date of adoption of the AB and panel reports (March 21, 2005).[34] As a result, the panel recommended that, upon adoption of its final report, the United States take appropriate steps to remove the adverse effects or to withdraw those subsidies identified as contributing to serious prejudice to the interests of Brazil — marketing loan provisions, Step-2 payments, and CCP payments — by September 21, 2005. Thus, in every other respect, the timetable for actionable subsidies would follow the same sequence of events listed above for prohibited subsidies, but subject to the full time allotment for each event as described in the preceding footnotes rather than the "halved" time periods.

U.S. Response to the DS Panel Ruling. A spokesperson for the Office of the U.S. Trade Representative (USTR) expressed disappointment in the AB ruling, but also said that USTR would study the AB report carefully and work closely with Congress and U.S. farmers on its next steps.[35] However, U.S. officials have said that they prefer to resolve the cotton case through trade negotiations in the WTO Doha Round rather than a separate settlement.[36] The National Cotton Council (NCC) of America — the principal national organization representing the interests of U.S.

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[31] Normally a 30-day period is given for authorization (DSU, Article 22.6); however, for disputes involving prohibited subsidies the prescribed time is halved (SCM, Article 4.12).

[32] Normally a 60-day period is given for arbitration (DSU, Article 22.6); however, for disputes involving prohibited subsidies the prescribed time is halved (SCM, Article 4.12).

[33] For more information, see CRS Report RL32014, *WTO Dispute Settlement: Status of U.S. Compliance in Pending Cases*, by Jeanne Grimmett.

[34] In accordance with SCM, Article 7.9.

[35] *Inside U.S. Trade*, "Appellate Body Favors Brazil in Cotton Subsidies Challenge," Vol. 23, No.9, March 4, 2005.

[36] *Congressional Daily*, "Comply Quickly With WTO Ruling, Brazil Urges U.S." March 15, 2005.

producers, ginners, warehousers, merchants, cottonseed processors/dealers, cooperatives and textile manufacturers — also expressed disappointment in the AB ruling, but has stated that it would work with USTR and USDA to coordinate a response to the decision.[37]

On July 1, 2005, USDA instituted a temporary fix for its export credit guarantee programs, whereby the Commodity Credit Corporation (CCC) would use a risk-based fee structure for the GSM-102 and SCGP programs. The new structure responded to a key finding by the WTO that the fees charged by the programs should be risk-based. User fees for GSM-102, the primary export credit program, presently are capped at 1% of the value of the export product (7 U.S.C. 5641). Higher fees are needed to ensure that the financial benefits returned by these programs fully cover their long-run operating costs; thereby eliminating their subsidy component. In addition, the CCC stopped accepting applications for payment guarantees under GSM-103. On July 5, 2005, USDA Secretary Johanns proposed that Congress implement statutory changes to comply with the prohibited subsidy ruling that included the removal of the 1% cap on fees that can be charged under the GSM-102 program and termination of the GSM-103 program.[38]

On August 1, 2006, the Step 2 cotton program, which was authorized by the 2002 farm act (P.L. 107-171; Sect. 1207), was eliminated by a provision (Sec. 1103) in the Deficit Reduction Act of 2005 (P.L. 109-171). At this point the Administration felt that sufficient program changes had been enacted to fully comply with the "actionable subsidies" portion of the WTO ruling. Furthermore, it is likely that the Administration deemed that Congress would have the opportunity to make further adjustments, if needed, when it passed new farm legislation in 2007 (as current farm law expires in 2007).

Brazil Seeks $4 Billion in Retaliatory Trade Measures. According to WTO rules, trade sanctions are limited to a value not to exceed the level of lost benefits. As the reform deadlines under the two different subsidy types expired, Brazil first requested (July 4, 2005) authorization from the WTO to impose $3 billion in countermeasures against the prohibited U.S. subsidies. This value corresponds to (1) Step 2 payments made in the then-most-recently-concluded marketing year (2004/05) and (2) the total of exporter applications received under the three export credit guarantee programs, for all unscheduled commodities and for rice, for the then-most-recent fiscal year (2004).[39] To achieve $3 billion in retaliation, Brazil proposed to suspend tariff concessions as well as obligations under the WTO Agreement on Trade-Related Intellectual Property Rights and the General Agreement on Trade in Services. The United States objected to the amount of Brazil's proposed sanctions,

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[37] NCC, "NCC Statement on WTP Appellate Ruling," March 3, 2005; available at [http://www.cotton.org/news/releases/2005/wtostatement.cfm].

[38] USDA press release No. 0242.05, July 5, 2005.

[39] For details, see CRS Report RL32014, *WTO Dispute Settlement: Status of U.S. Compliance in Pending Cases*, by Jeanne J. Grimmett.

and requested WTO arbitration.[40] However, on August 18, 2005, the United States and Brazil reached a procedural agreement temporarily suspending arbitration proceedings concerning the prohibited subsidies.[41]

Second, as the September 21, 2005, deadline to address the actionable subsidy ruling expired, Brazil charged that the United States had neither taken nor announced any specific initiative for the price-contingent programs deemed to cause prejudicial impact to Brazil's trade interest. Brazil then requested authorization from the WTO to impose countermeasures valued at $1 billion as retaliation against the actionable programs. Once again, the United States requested (October 18, 2005) WTO arbitration over the level of the proposed sanctions.[42] Again, the United States and Brazil reached a procedural agreement (December 7, 2005), thereby temporarily suspending further retaliation proceedings on the actionable subsidies.[43]

Brazil Requests a Compliance Panel

Initially Brazil showed a willingness to permit the U.S. legislative process — motivated by the 2007 expiration of U.S. farm programs and by the prospects of a successful Doha Round of trade negotiations — to make the changes needed to bring U.S. farm programs into compliance with the WTO ruling, even if this process extended well beyond the deadlines established under the WTO dispute settlement ruling. However, in July 2006, the Doha Round talks were suspended indefinitely. Shortly thereafter, on August 21, 2006, Brazil submitted a request for a WTO compliance panel to review whether the United States had fully complied with panel and AB rulings. The WTO's Dispute Settlement Body (DSB) agreed to establish a compliance panel at the September 28, 2006, DSB meeting. On October 15, 2007, the compliance panel released its final report to the United States and Brazilian governments. According to news reports, the panel's ruling confirmed an earlier (July 27, 2007) interim ruling that the United States has not fully complied with a March 2005 WTO ruling against certain U.S. cotton support programs.[44]

The United States is expected to appeal the compliance panel's ruling. If appealed, an Appellate Body decision would not be likely until mid-2008. The ruling against the United States (barring a successful U.S. appeal) could necessitate further U.S. farm program changes or, if no further changes are forthcoming, clear the way for Brazil to request WTO authorization for retaliatory trade sanctions. First, however, Brazil would likely ask the WTO arbitration panel to resume its work, with a decision within 60 days, according to the U.S.-Brazil agreement on prohibited subsidies. U.S. failure to comply with any decision could result in WTO-sanctioned

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[40] WTO official document WT/DS267/24, July 19, 2005. Official WTO documents are accessible online at [http://docsonline.wto.org/gen_search.asp?searchmode=simple].

[41] WT/DS267/25, August 18, 2005.

[42] WT/DS267/27, October 18, 2005.

[43] WT/DS267/29, December 7, 2005.

[44] For example, see *The Financial Times*, "WTO Rules Against U.S. Cotton Subsidies," October 15, 2007.

trade retaliation by Brazil against the United States. The U.S. response to the WTO cotton ruling is being watched closely by developing countries, particularly by a consortium of four African cotton-producing countries that has submitted its own proposal to the WTO calling for a global agreement to end all production-related support for cotton growers of all WTO-member countries.[45]

Potential Implications of WTO Panel Ruling

Trade experts have expressed concern that the panel findings could extend beyond cotton to other major field crops, particularly as concerns the potential limits on export credit guarantees. Some trade and market analysts, as well as legislators, have expressed concern that a broad finding against U.S. farm program provisions under the actionable subsidies ruling could necessitate legislative changes to the U.S. farm bill, which is scheduled to expire in 2007, to bring existing program operations into compliance.

Concerns have also been expressed regarding the reclassification of PFC and Direct Payments away from non-trade-distorting green box support.[46] However, the panel finding that U.S. direct payments do not qualify for WTO exemptions from reduction commitments as fully decoupled income support (i.e., they are not green box compliant) appears to have no further consequences within the context of this case and does not involve any compliance measures. This is because direct payments were deemed "non-price contingent" and were evaluated strictly in terms of the Peace Clause violation.

The panel did not specifically reclassify U.S. PFC and DP payments as "amber box," nor did the panel recommend that the United States should notify such future payments as "amber box." This is a subtle but critical distinction because of the enormity of PFC and DP payments. During FY1996 to FY2006, PFC and DP payments averaged $5 billion per year and accounted for 26% of total U.S. farm program outlays. Shifting this amount to amber box could have important implications for future dispute settlement cases, as well as for the United States' ability to meet its WTO amber box commitments.

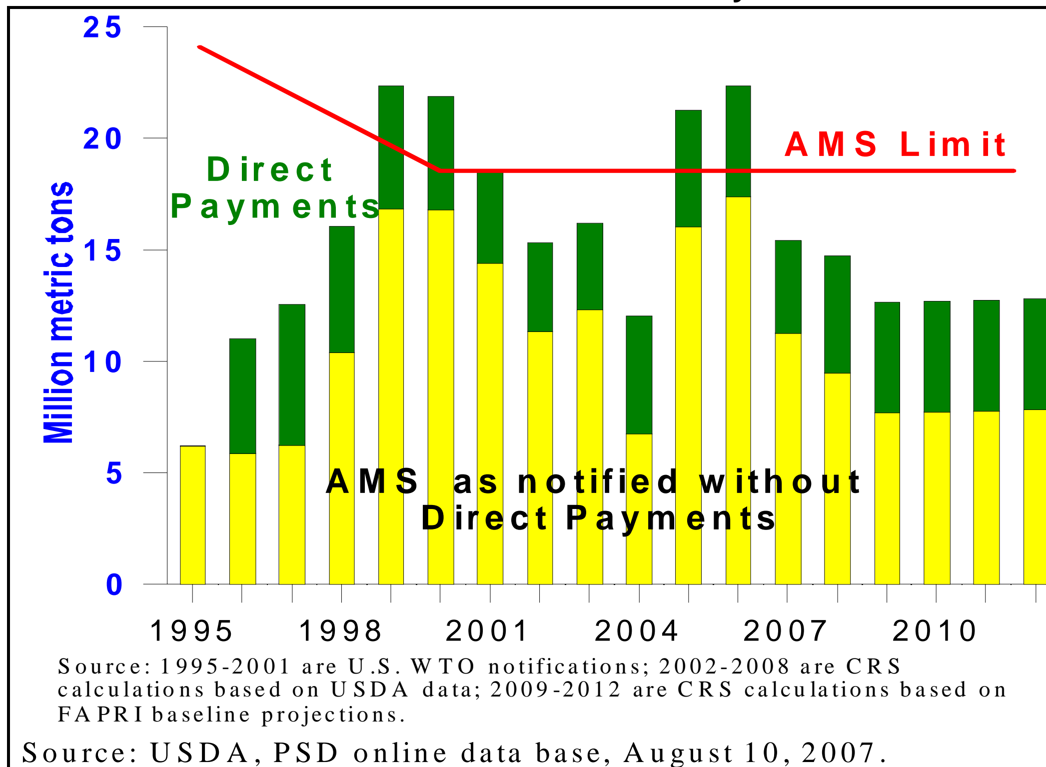
U.S. cotton industry and government officials are concerned that the specific finding on the apparent failure of U.S. "decoupled" payments to meet WTO green box criteria leaves such programs open to future charges, and that third countries may feel emboldened by knowing how a WTO panel is likely to rule on such matters. The European Union (EU) is also likely to be concerned about this finding since the EU's agricultural program (following agricultural policy reforms of June 2003) relies heavily on "decoupled" payments similar to the those of the U.S. program. These concerns appear to have merit, as both Canada and Brazil have initiated the first phases of WTO dispute settlement proceedings contending that the United States has indeed incorrectly notified PFC and DP payments as green box and that their

[45] For more information, see CRS Report RS21712, *The African Cotton Initiative and WTO Agriculture Negotiations*, by Charles Hanrahan.

[46] "Brazil Wins Key Points in Interim WTO Panel on U.S. Cotton Subsidies," *Inside U.S. Trade*, April 30, 2004.

inclusion in the U.S. amber box results in the United States exceeding its WTO-agreed AMS spending limit on several occasions in recent years (**Figure 5**).[47]

Figure 5. U.S. AMS Outlays — As Notified Without Direct Payments versus With Addition of Direct Payments



Source: USDA, PSD online data base, August 10, 2007.

Other Cotton-Related Trade Issues

Besides Brazil's WTO-initiated dispute settlement case (DS267), U.S. cotton subsidies are being challenged at the WTO on two additional fronts.

- First, the Doha Development Agenda negotiating round has substantial reductions in trade-distorting domestic program support as one of its principal modalities.[48] If realized, a new round of domestic spending limitations could potentially represent a "real" ceiling on U.S. commodity spending and could result in lower program outlays.

- Second, a consortium of four African cotton-producing countries — Benin, Burkina Faso, Chad, and Mali — has submitted a WTO proposal calling for a global agreement to end all production-related

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[47] For more information on the Canada case see CRS Report RL33853, *Canada's WTO Case Against U.S. Aggregate Measure of Support (AMS)* by Randy Schnepf. Brazil's request for WTO consultations concerning U.S. AMS limits is WT/DS365/1, July 17, 2007.

[48] WTO, Doha Ministerial Declaration, WT/MIN(01)/DEC/1, November 20, 2001.

> support for cotton growers of all WTO-member cotton producing nations.[49] In acknowledgment of the concerns of African cotton-producing countries, the United States — while not agreeing with the African proposal — worked with the African countries on a formulation in the recently completed agriculture framework (July 31, 2004) of the WTO's ongoing Doha Round.[50] Although no specific cotton program concessions were mentioned in the framework, the United States committed "to achieve ambitious results expeditiously" under the framework. Further, it is notable that cotton is the only commodity singled out for special mention in the framework.

Role of Congress

Given the importance of cotton in the U.S. agricultural economy and the potential for WTO-imposed limitations on U.S. cotton program operations, Congress likely will be closely monitoring developments in the WTO cotton case and the impending compliance panel's final ruling. Both the Senate and House Agriculture Committees regularly hold hearings on agricultural trade negotiations. In addition to congressional hearings, Congress will likely be engaged in consultations with the Administration on the bilateral trade negotiations as well as the Doha Round of WTO trade negotiations. Such consultations will be a major vehicle for Members to express their views on this dispute and on the negotiating issues it raises.

Ultimately, Congress is responsible for passing farm program legislation that complies with U.S. commitments in international trade agreements. The United States has already complied with at least a portion of the AB's recommendation by eliminating the Step 2 program. However, additional permanent modifications to U.S. farm programs may still be needed to fully comply with the AB's ruling pending a final determination by the WTO compliance panel.

When confronted with a negative WTO dispute settlement ruling, a country has essentially five options to choose from: eliminate the subsidy; reduce the subsidy to diminish its adverse effect; revise the program function to reduce the linkage between the subsidy and the adverse effect (referred to as decoupling); pay a mutually acceptable compensatory payment to offset the adverse effects of the subsidy; or suffer the consequences of trade retaliation.

The legislation authorizing current farm programs expires in late 2007. The House passed its version of the 2007 farm bill — H.R. 2419 — on July 27, 2007. In H.R. 2419, the House proposes several changes specifically relevant to the Brazil cotton case, but also germane to the broader issue of program vulnerability to WTO

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[49] For more information, see CRS Report RS21712, *The African Cotton Initiative and WTO Agriculture Negotiations.*

[50] For more information, see CRS Report RS21905, *Agriculture in the WTO Doha Round: The Framework Agreement and Next Steps*.

challenge.[51] Sec. 3002 repeals the GSM 103 and SCGP programs and lifts the 1% origination fee cap on GSM 102 export credit. These statutory changes appear likely to eliminate the "subsidy" component of export credit guarantees and bring them into compliance with WTO rules.

However, H.R. 2419 appears to do very little in response to the serious prejudice charge related to price-contingent subsidies. Instead, H.R. 2419 extends both current marketing loan provisions (Sec. 1201-1205) and the CCP program (Sec. 1103). The target price for upland cotton is adjusted downward by 2.4 cents to 70 cents per pound, which should marginally lower expected CCC outlays for cotton; however, H.R. 2419 offers producers an additional revenue-based CCP option (Sec. 1104) that includes significantly higher per-acre revenue guarantees for cotton than under the 2002 farm bill (i.e., $496.93 under H.R. 2419 versus $416.73 under current law). In addition, H.R. 2419 proposes changing the world price used by USDA to determine marketing loan repayment rates from a Northern European price to a Far Eastern price, which presumably would result in larger payments under the provisions of the program. H.R. 2419 (Sec. 1207(c)) also creates a new cotton user payment of 4 cents per pound. This payment is similar to the WTO-illegal Step 2 payment except that cotton from all origins (not just domestic sources) is eligible for the payment. Since the United States imports very little cotton, most payments would still likely go to domestically sourced cotton. As a result, this subtle technical loophole might be subject to WTO challenge if it survives the congressional legislative process and emerges as part of a new farm bill.

Finally, H.R. 2419 fails to address the issue surrounding the disqualification of direct payments from WTO's green box AMS exclusion as decoupled payments due to the planting restriction on fruits, vegetables, and wild rice on program base acres. Instead, direct payments are extended with no change to current planting restrictions (except for a small pilot program on 10,000 acres in Indiana). This glaring retention of the status quo has important WTO implications, as both Canada and Brazil have recently initiated WTO cases against the United States (as mentioned earlier) charging that the United States has exceeded its total AMS limit on several occasion in recent years if direct payments are included in the AMS calculation (**Figure 5**).

The Senate Agriculture Committee is expected to mark up its version of a 2007 farm bill in October. In response to the negative WTO compliance panel interim ruling in July, Senate Agriculture Committee Chairman Tom Harkin stated, "It would be far preferable to settle these disputes through careful negotiation instead of WTO litigation. While, of course, the United States needs to defend our programs in the WTO, we also must recognize reality, solve the problems in our programs and move on. It is far more important to prepare for the future so American agriculture can succeed in this new century than to continue fighting losing cases before the WTO."[52]

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[51] For more information on this issue, see CRS Report RS22522, *Potential Challenges to U.S. Farm Subsidies in the WTO: A Brief Overview* by Randy Schnepf and Jasper Womach.

[52] "Harkin Disappointed with WTO Decision on Compliance in Brazil Cotton Case," Senator Tom Harkin, Press Release, July 27, 2007.