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Status of the WTO Brazil-U.S. Cotton Case

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Summary

The so-called "Brazil cotton case" is a long-running World Trade Organization (WTO) dispute settlement case (DS267) initiated by Brazil—a major cotton export competitor—in 2002 against specific provisions of the U.S. cotton program. In September 2004, a WTO dispute settlement panel ruled that (1) certain U.S. agricultural support payments for cotton distorted international agricultural markets and should be either withdrawn or modified to end the market distortions; and (2) U.S. Step-2 payments and agricultural export credit guarantees for cotton and other unscheduled commodities were prohibited under WTO rules and should be withdrawn.

In 2005, the United States made several changes to both its cotton and GSM-102 programs in an attempt to bring them into compliance with WTO recommendations; however, Brazil argued that the U.S. response was inadequate. A WTO compliance panel ruled in Brazil's favor and was upheld on appeal. In August 2009, a WTO arbitration panel—assigned to determine the appropriate level of retaliation—announced that Brazil's trade countermeasures against U.S. goods could include two components: (1) a fixed annual payment by the U.S. government to Brazil of $147.3 million, and (2) a variable annual amount based on U.S. GSM-102 program spending. In addition, Brazil argued for and received authority for cross-retaliation—that is, to impose countermeasures in sectors outside of the trade in goods, most notably in the area of U.S. copyrights and patents.

The threat of retaliation led Brazil and the United States to negotiate a temporary mutual agreement (June 17, 2010) to avoid trade retaliation. Key aspects of the agreement included U.S. payments of $147.3 million annually to the "Brazilian Cotton Institute" to provide technical assistance and capacity-building for Brazil's cotton sector; regular discussions on potential limits of trade-distorting U.S. cotton subsidies (recognizing that actual changes will not occur prior to the next farm bill); and modifications to the operation of the GSM-102 program coupled with a semi-annual review of whether U.S. GSM-102 program implementation satisfies certain performance benchmarks.

Both Brazil and the United States have hoped that the WTO cotton dispute would be resolved definitively within the context of the next U.S. farm bill. In this regard, both the Senate-passed (S. 954) and House-passed (H.R. 2642) 2013 farm bills are in agreement over proposed changes to U.S. cotton support programs—cotton would no longer be included as a major program commodity, thus losing eligibility for certain price and income support programs proposed in Title I of the farm bill. Instead, those programs would be replaced by a new cotton program comprised of a stand-alone, county-based revenue insurance policy called the Stacked Income Protection Plan (STAX). The House- and Senate-passed farm bills are presently in conference to resolve differences. While a new farm bill might address issues related to the WTO Brazil-U.S. cotton case from a U.S. perspective, Brazil still retains substantial authority in making a final determination regarding the compliance of any policy changes to U.S. cotton support programs.

Furthermore, the heightened attention surrounding the WTO Brazil-U.S. cotton case has served to single out cotton for special treatment within ongoing WTO trade negotiations and to bring into international focus the proposed changes to U.S. farm programs for cotton in the next farm bill. Such heightened international awareness could intensify pressures on both Brazil and the United States to resolve the cotton dispute in a transparent and widely acceptable manner so as to minimize further repercussions in future WTO trade negotiations or dispute settlement cases.

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Introduction

This report provides a description and status report on Brazil's challenge to certain aspects of the U.S. cotton program under the rules of the World Trade Organization's (WTO's) dispute settlement process in case DS267.

The "Brazil-U.S. cotton case" had its WTO origins in 2002 and has since evolved into a sprawling legal enterprise that is still ongoing as of 2013. For a detailed description of the case's origin and progress through the WTO dispute settlement process to the point in April 2011 when Brazil and the United States reached an agreement (referred to as the U.S.-Brazil framework agreement), readers may refer to archived CRS Report RL32571, *Brazil's WTO Case Against the U.S. Cotton Program*.

This report focuses on developments in the cotton case since 2011; in particular, the status of three aspects of the WTO cotton case:

- the nature and calculation of Brazil's authority to retaliate;
- changes to U.S. agricultural policy (both resultant and pending) that have occurred as a direct result of the WTO cotton case, and Brazil's response to them; and
- the broader implications for U.S. farm policy of the WTO cotton initiative—a direct offspring of the Brazil-U.S. cotton case—within ongoing WTO trade negotiations.

Each of these case aspects remains highly germane to U.S. farm policy and programs, as Brazil still retains the WTO-granted authority to impose millions of dollars of trade retaliation against U.S. goods and services. In addition, with the world closely watching the resolution of the Brazil-U.S. cotton case, the final terms and circumstances of such a resolution—were it to occur—could serve either as catalyst or as precedent for future trade disputes related to the agricultural sector, and/or as progenitor of new, more restrictive WTO rules for domestic cotton support programs.

Brief Historical Overview of the WTO Case

The so-called "Brazil-U.S. cotton case" is a long-running WTO dispute settlement case (DS267) initiated by Brazil—a major cotton export competitor—in 2002 against specific provisions of the U.S. cotton program. Brazil charged that U.S. cotton programs were depressing international cotton prices and thus artificially and unfairly reducing the quantity and value of Brazil's cotton exports, causing economic harm to Brazil's domestic cotton sector.

Dispute Settlement and Arbitration

In September 2004, after nearly a year-long period of hearings and review, a WTO dispute settlement panel found that certain U.S. agricultural support payments and guarantees were inconsistent with WTO commitments and resulted in market distortions that depressed international cotton prices, as claimed by Brazil. In addition, certain U.S. agricultural export programs were found to be illegal under WTO rules. As a result, U.S. support programs were

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found to violate two different types of WTO rules and thus required two different types of responses from the United States to remedy the inconsistencies.

First, actionable subsidies were those subsidies identified as having distorted normal market conditions and resulted in adverse effects to Brazil. The WTO panel recommended that the United States take appropriate steps by September 21, 2005, to remove the adverse effects or to withdraw the subsidy measures singled out as price-contingent—marketing loan provisions, Step 2 payments,[1] and counter-cyclical program (CCP) payments.[2]

Second, prohibited subsidies were those subsidies deemed illegal under WTO rules. The panel identified export credit guarantee programs—GSM-102, GSM-103, and the Supplier Credit Guarantee Program (SCGP)[3]—that assisted cotton and other "unscheduled" agricultural products entering international markets, and Step 2 payments to both domestic users and exporters of upland cotton. The WTO panel recommended that the United States withdraw these programs by July 1, 2005.

In 2005, the United States made several changes to both its cotton farm support programs and export credit guarantee programs in an attempt to bring them into compliance with WTO recommendations. However, Brazil argued that the U.S. response was inadequate and requested authority to impose $3 billion in retaliation against prohibited U.S. subsidies. Retaliation generally takes the form of higher tariffs, above WTO bound levels.

The United States objected to Brazil's requested retaliation amount and called for WTO arbitration; however, arbitration was mutually suspended in July 2006. Shortly thereafter (August 2006), Brazil requested a WTO compliance panel to review whether the United States had brought its cotton programs into compliance with the original WTO panel ruling. In December 2007, a WTO compliance panel ruled in favor of Brazil's noncompliance charge against the United States, and the ruling was upheld on appeal in June 2008.

WTO Authorizes Retaliation Authority for Brazil

In August 2008, Brazil requested resumption of arbitration over its proposed retaliation value of $3 billion. In August 2009, the WTO arbitration panel announced that Brazil's trade countermeasures against U.S. goods and services could include two components:

[1] Step 2 payments were 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 were 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 was 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. in Northern Europe from any source. The Step 2 cotton program was eliminated on August 1, 2006 (§1103, P.L. 109-171).

[2] For a description of U.S. farm programs, see CRS Report RL34594, *Farm Commodity Programs in the 2008 Farm Bill*.

[3] GSM-103 and SCGP were eliminated by the 2008 farm bill (P.L. 110-246; §3101(a)) upon its enactment on June 18, 2008. For information on the U.S. GSM-102 program, see USDA, Foreign Agricultural Service, "Export Credit Guarantee Programs," at http://www.fas.usda.gov/excredits/default.htm.

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- a fixed annual payment by the U.S. government to Brazil of $147.3 million in response to the actionable subsidies (i.e., market-distorting U.S. cotton program payments), and
- a variable formula-derived retaliation amount based on annual spending made under the U.S. GSM-102 program in response to the prohibited subsidies.

According to WTO rules, trade retaliation should take place within the sector where the violation occurred. In this case, retaliation normally would be restricted to punitive tariffs on U.S. goods entering Brazil. However, Brazil argued that limiting retaliation to the goods sector alone would have a more deleterious effect on the Brazilian economy (via higher input costs) and Brazilian consumers (via higher inflation) than on U.S. exporters due to the asymmetries between the two economies.[4] Instead, Brazil proposed to suspend tariff concessions as well as obligations under the WTO Agreement on Trade-Related Intellectual Property Rights (TRIPS) and the General Agreement on Trade in Services (GATS).

In response to Brazil's concerns regarding applying retaliation entirely in the goods sector based on trade between the two countries, the arbitrators ruled that Brazil would be entitled to cross-retaliation if the overall retaliation amount exceeded a formula-based, variable annual threshold—different from the earlier formula used for calculating the total annual retaliation.[5] Cross-retaliation involves countermeasures in sectors outside of the trade in goods—for example, in the area of U.S. copyrights, patents, and other intellectual property rights (IPR). Based on the arbitrators' formulas, using 2008 data, Brazil announced in December 2009 that it would impose trade retaliation starting on April 6, 2010, against up to $829.3 million in U.S. goods, including $268.3 million in eligible cross-retaliatory countermeasures.

Temporary Suspension of Retaliation

The threat of sanctions led to intense negotiations between Brazil and the United States to find a mutual agreement and avoid trade retaliation. While U.S. exporters were anxious about losing trade with the emerging Brazilian domestic market, Brazil's domestic manufacturing and business sectors were concerned that trade retaliation in the form of higher tariffs could be counter-productive if it resulted in restricting access by domestic industry to key inputs.

In April 2010, the two parties agreed on a memorandum of understanding (MOU) that spelled out certain actions which, if undertaken by the United States, would lead to suspension of Brazil's threatened retaliation. Then, on June 17, 2010, U.S. and Brazilian trade negotiators concluded the *Framework for a Mutually Agreed Solution to the Cotton Dispute in the WTO (WT/DS267)*. The "Framework Agreement"—which laid out a number of "steps and discussions"—represented a path forward toward the ultimate goal of reaching a negotiated solution to the dispute, while avoiding WTO-sanctioned trade retaliation by Brazil against U.S. goods and services (and possibly IPR).

As a result, Brazil suspended trade retaliation pending U.S. compliance with the Framework Agreement measures. Key aspects of the Framework Agreement include (1) payment by the

[4] "U.S., Brazil Clash on Cotton Sanctions," International Center for Trade and Sustainable Development (ICTSD), *Bridges*, vol. 12, no. 6, January 2009.

[5] These formulas are described in more detail in a later section, "Brazil's Trade Retaliation Authority Explained."

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United States of a $147.3 million annual fund (or $12.275 million per month) to a newly created "Brazilian Cotton Institute" to provide technical assistance and capacity-building for Brazil's cotton sector, (2) quarterly discussions on potential limits of trade-distorting U.S. cotton subsidies (recognizing that actual changes will not occur prior to the next farm bill), and (3) near-term modifications to the operation of the GSM-102 program coupled with a semi-annual review of whether U.S. GSM-102 program implementation satisfies certain performance benchmarks.

These U.S. commitments were intended to delay any trade retaliation until after the next farm bill, when potential changes to U.S. cotton programs would be evaluated.

Brazil's Trade Retaliation Authority Explained

As stated earlier, a WTO arbitration panel announced that Brazil's trade countermeasures against U.S. goods and services could include two components—a fixed amount and a variable amount. Each of these components is described in more detail here.

Fixed Component

A fixed annual payment of $147.3 million was based on Brazil's share (5.1%) of the calculated global market price effect resulting from the international price-depressing nature of U.S. cotton programs. This calculation was undertaken using U.S. and international market data for the 2005 marketing year. The analysis found that, in the absence of U.S. marketing loan benefits, Step 2 payments, and counter-cyclical payments to U.S. cotton producers, the world price of cotton would have been 9.38 cents per pound higher, and that the estimated worldwide losses for both trade and production effects were $2.9 billion. Since Brazil's share of world cotton production (excluding the United States) at that time was 5.1%, this same share of the global loss was assigned to Brazil as the fixed payment.

Formula-Based Variable Component

An annual, variable retaliatory amount was included to account for U.S. agricultural exports made under the GSM-102 program. Furthermore, the WTO arbitrator ruled that the retaliatory amount accorded Brazil would vary each year based on the total of exporter applications received by the U.S. government under the GSM-102 program for the most recently concluded fiscal year—the formula would consider an interest rate subsidy component and a component to reflect any measurable trade displacement—referred to as "additionality." The WTO arbitrator used Brazil's share of world trade of those products receiving GSM-102 credit guarantees (estimated at 11.7% in 2006) to apportion Brazil's share of the estimated global subsidy effect of GSM-102.

Since the authority for cross-retaliation was based on the value of trade in goods between Brazil and the United States, annual changes in the value of trade in goods need to be considered in order to ascertain a fair value for cross-retaliation. For purposes of determining eligibility to apply cross-retaliation, the panel established an initial threshold amount of $409.7 million that could be subject to countermeasures without harming Brazil's economy based on the volume and composition of Brazil's imports of consumer goods in the year 2007. The amount of $409.7 million represents the sum of the value of those consumer goods imported by Brazil where the U.S. share is less than 20%, excluding books and automotive parts, which are considered essential to Brazil's economy.

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The threshold amount may vary from year to year according to the following formula:

$T_{t+1} = T_t * (1 + g_{t+1})$ where $T_{2007} = \$409.7$ million

where

T_{t+1} = threshold value in year t+1
T_t = threshold value in year t
g_{t+1} = percentage change in the value of Brazil's total imports from the United States between years t and t+1.

Estimated Retaliation Authority Based on Recent Data

Both U.S. policy changes and trade flows have altered the formula calculations in the United States' favor in recent years. USDA has made several changes in how it implements the GSM-102 program (described below), while the changing nature of U.S.-Brazil trade flows is working to severely restrict both the amount and the nature of the retaliatory rights to which Brazil is entitled. Based on 2011 data, it was estimated that Brazil was entitled to roughly $500 million in total retaliation.[6] This compares with retaliation authority estimates of $829 million using 2008 data and $1 billion using data from 2009.

Not only has the total retaliation authority declined in recent years, but so too has the authority for cross-retaliation. For instance, using 2008 data, about $269 million of the $829 million in total retaliation could be applied in cross-retaliation. Similarly, Brazil enjoyed cross-retaliation rights of about $550 million out of $1 billion total retaliation using 2009 data.[7] In sharp contrast, estimates for 2011 indicate that the cross-retaliation threshold would be higher than the total retaliation value of $500 million, meaning that Brazil would have no ability to engage in cross-retaliation.

The fact that Brazil is not entitled to any cross-retaliation when 2011 data are used depends heavily on the value of U.S. exports in goods to Brazil, which have skyrocketed over the last several years. According to U.S. Census Bureau export data, which are somewhat less precise than the Brazilian import data used for the retaliation calculations, U.S. exports to Brazil totaled about $26.1 billion in 2009, but climbed in 2010 to $35.4 billion, and to $42.9 billion in 2011.[8] This surge partly reflects the fact that the U.S. dollar had depreciated vis-a-vis Brazil's currency, making U.S. exports more attractive to Brazilian consumers.

If recent developments are limiting the amount and nature of Brazil's retaliatory rights, that could mean that Brazil has less ability going forward to use retaliation as leverage to convince the U.S. Congress to pass a farm bill that would fully bring the United States into compliance with its WTO obligations.

[6] *Inside U.S. Trade*, "GSM-102 Tweaks, Recent Data Limit Brazil's WTO Cotton Retaliation Rights", June 21, 2012.

[7] Ibid.

[8] Ibid.

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U.S. Policy Changes in Response to Cotton Case

Since 2005, the United States has made several changes to both its cotton and GSM-102 programs in an attempt to bring them into compliance with WTO recommendations. In addition, Congress has passed legislation to permanently eliminate the Step 2 program and GSM-103 and SCGP export credit guarantee programs. As a result, the United States has argued that the basket of potentially distorting programs in question has been so transformed as to render moot the issue of adverse effects or threat of serious prejudice. However, Brazil has consistently argued that the U.S. policy response has been inadequate. In an attempt to definitively resolve the cotton dispute, Congress is proposing a complete revamping of the existing cotton price and income support programs by replacing most of them with an insurance-like program (described below) where producers must pay into the program in order to participate.

Program Changes to Date

Eliminated Step 2 program

In order to address the issue of actionable subsidies in the Brazil-U.S. cotton case, the U.S. Congress, on August 1, 2006, eliminated the Step 2 cotton program by a provision (§1103) in the Deficit Reduction Act of 2005 (P.L. 109-171).

Modified or Eliminated Export Credit Guarantee Programs

In order to address the issue of prohibited export subsidies several steps have been taken by USDA and Congress.

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. Higher program-participation fees would ensure that the financial benefits returned by these programs fully cover their long-run operating costs, and eliminate the subsidy component. USDA adopted the risk-based fee structure since the cap was required by statute (7 U.S.C. 5641) and could not be removed administratively. In addition, the CCC stopped accepting applications for payment guarantees under GSM-103.

On June 18, 2008, the date of enactment of the 2008 farm bill (P.L. 110-246), a provision (§3101(a)) in the Trade title (Title III) eliminated the GSM-103 and SCGP programs, and removed the 1% cap on fees that could be charged under the GSM-102 program.

In addition, the same 2008 farm bill provision explicitly required the Secretary of Agriculture, in carrying out the GSM-102 program, to "work with the industry to ensure, to the maximum extent practicable, that risk-based fees associated with the guarantees cover, but do not exceed, the operating costs and losses over the long-term." However, the 2008 farm bill defined the "long-term" as a period of 10 or more years. While the WTO panel did not explicitly define its view of

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the "long-term," it clearly is less than 10 years and more likely is on the order of a period of two years[9]—that is, a net loss in one year must be offset by a net gain in the following year.

These alterations to the GSM-102 program have contributed to the recent drop in Brazil's retaliatory rights, as mentioned earlier. This is in spite of the fact that total usage of the GSM-102 program has actually increased in recent years. In particular, two additional changes to GSM-102 operation made in 2010 are also helping to drive down Brazil's retaliation rights. First, USDA blocked Brazilian banks from being able to enjoy the loan guarantees for the financing of U.S. agricultural exports. Second, USDA disqualified Brazil as an export destination for third-country banks seeking such loan guarantees.

The WTO formula for calculating annual retaliatory authority assumes that GSM-102-backed loans by Brazilian banks to importers in Brazil have a particularly negative impact on Brazilian agricultural producers. As a result, the existence of such loans prior to 2010 had the effect of driving up Brazil's retaliatory rights by a significant amount, as those measures were meant to counteract the harm done to Brazilian agricultural producers.[10] These alterations have had the effect of driving down Brazil's retaliation rights since 2010.

Compliance with Brazil-U.S. Framework Agreement

Under the Brazil-U.S. Framework Agreement, the United States was to make payments to the Brazilian cotton fund of about $12.275 million every month for a total of $147.3 million annually, which can be used to aid the development of Brazil's cotton industry. Although the Framework Agreement and its monthly payments succeeded in avoiding, at least temporarily, the imposition of harmful trade countermeasures, the U.S. proposal was met with both praise and criticism. Proponents of U.S. farm programs (and their incumbent support payments) were generally in favor of the ongoing negotiations and the U.S. proposal. In contrast, opponents and critics of U.S. farm programs were generally critical of the U.S. negotiating offer. In particular, the establishment of the $147.3 million annual fund to support Brazil's cotton sector was described as "subsidy payments to Brazil's cotton farmers needed to permit the continuation of subsidy payments to U.S. cotton farmers."[11] During 2011, several amendments were introduced in the House that would have eliminated or banned the payments to Brazil; however, none of these amendments was enacted.[12]

In September 2013, USDA—claiming the effects of the federal budget sequestration process were at play—reduced the payment to Brazil by an amount equal to 5% of the annual total ($7.35 million), leaving a payment of just $4.9 million.[13] In October, USDA completely stopped the payments. Although his remarks were disputed by several trade experts, Agriculture Secretary Tom Vilsack claimed without elaboration that the U.S. government lost the authority on October 1, 2013, to continue making payments to Brazil under the temporary WTO settlement.[14]

[9] Annex J, paragraph 3(a), of the "2008 Revised Draft Modalities" sets 180 days as the maximum repayment terms for an export credit guarantee contract.

[10] Ibid.

[11] Michael Grunwald, "Why the U.S. Is Also Giving Brazilians Farm Subsidies," *Time*, April 9, 2010.

[12] See CRS Report RL32571, *Brazil's WTO Case Against the U.S. Cotton Program*.

[13] *Inside U.S. Trade,* "U.S. Cuts Cotton Payment, Leading Brazil To Gear Up For Retaliation," October 3, 2013.

[14] *Inside U.S. Trade,* "Experts: Vilsack Claim On Brazil Payment Authority Expiration Is Untrue," August 15, 2013.

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In light of the U.S. failure to continue with the payments, Brazil's Foreign Trade Board (known by its Portuguese acronym CAMEX) is slated to convene December 18, 2013, and consider a "menu" of options for retaliation against U.S. exports, including monetary value, method, timing, and sectors to be targeted. Brazilian Foreign Minister Luiz Alberto Figueiredo said that his country prefers to continue receiving payments from the United States under the interim cotton settlement as opposed to imposing trade retaliation on U.S. exports.[15] However, with Brazil's presidential election coming up in October 2014, the issue could grow more politicized with every passing day, making retaliation avoidance more difficult.

Proposed Policy Changes in Next Farm Bill

Both Brazil and the United States have hoped that the WTO cotton dispute would be resolved definitively within the context of the next U.S. farm bill. In this regard, both the Senate-passed (S. 954) and House-passed (H.R. 2642) 2013 farm bills are in agreement over proposed changes to U.S. cotton support programs designed to address the WTO cotton case—cotton would no longer be included as a major program commodity, thus losing eligibility for certain price and income support programs proposed in Title I.[16] Instead, both versions of the farm bill include a new cotton program comprised of a stand-alone, county-based revenue insurance policy called the Stacked Income Protection Plan (STAX).

The House- and Senate-passed farm bills are presently in conference to resolve differences. On December 10, 2013, top farm bill conferees announced that they were unable to complete a long-term bill by the end of the year (2013) because of a lack of agreement and a lack of Congressional Budget Office (CBO) scores. As a result, any conclusion to the farm bill is pushed into 2014.

The major cotton-related provisions in the House- and Senate-passed farm bills relevant to the Brazil-U.S. cotton case are briefly described here.

Eliminate or Modify Existing Price and Income Supports for Cotton

Under both the Senate- and House-passed farm bills, farm support for traditional program crops is restructured by eliminating direct payments, the counter-cyclical price (CCP) program, and the Average Crop Revenue Election (ACRE) program. Both bills would retain a form of counter-cyclical price program—either price- or revenue-based—that makes a farm payment when prices for covered crops decline below certain levels and would add a Supplemental Coverage Option (SCO) to crop insurance policies to address the issue of "shallow losses," or losses incurred by producers but not covered currently by crop insurance. However, cotton is not included as a program commodity eligible for either the counter-cyclical programs or the SCO.

Authority is continued for marketing assistance loans, which provide additional low-price protection at "loan rates" specified in current law (with an adjustment made to the upland cotton marketing loan, which would be reduced from $0.52/lb. to an effective floor of $0.47/lb. in the Senate bill and $0.45/lb. in the House bill).

[15] *Inside U.S. Trade*, "Minister Says Brazil Prefers Continuation Of Cotton Payments Over Retaliation," December 3, 2013.

[16] See CRS Report R42759, *Farm Safety Net Provisions in a 2013 Farm Bill: S. 954 and H.R. 2642*.

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Insurance-Like Stacked Income Protection Plan (STAX)

Both the House and Senate farm bills would handle cotton separately from the other major program crops. In lieu of the farm revenue programs proposed in Title I, both versions of the farm bill include a new cotton program comprised of a stand-alone, county-based revenue insurance policy called the Stacked Income Protection Plan (STAX).[17] Producers could purchase this policy in addition to their individual crop insurance policy or as a stand-alone policy.

Key Features of STAX include the following:

- STAX sets a revenue guarantee based on expected county revenue. In other words, it is an "Area-Wide" program which minimizes producer moral hazard.
- A revenue loss of at least 10% at the county level must occur before an indemnity from STAX is triggered.
- STAX would indemnify losses in county revenue of greater than 10% of expected revenue but not more than the crop insurance policy deductible level (e.g., 15%, 20%, or 25%) or not more than 30% if used as stand-alone policy without crop insurance.
- A payment rate multiplier of 120% is available if producers want to increase the amount of protection per acre.
- Unlike traditional farm price and income support programs, participation in STAX is not free. The farmer must pay 20% of the policy premium for STAX while a federal subsidy covers the remaining 80%.
- STAX participants are not eligible for benefits available under other field-crop programs including yield updating and revenue- and price-based counter-cyclical payments.

Repercussions from Brazil and U.S. Officials

Despite this program formulation, Brazil has yet to formally sign off on STAX as a solution to the WTO cotton case, but instead has indicated that STAX does not go far enough in resolving the dispute. In 2012, then-Brazilian Ambassador to the WTO Roberto Azevedo (now Director General of the WTO) wrote letters to Senate Agriculture Chairwoman Debbie Stabenow (January 2012) and U.S. Trade Representative Islam Siddiqui (July 9, 2012), and released a white paper conveying Brazil's dismay over the farm bill proposals, which Brazil has said would generally increase, rather than decrease, U.S. trade-distorting subsidies. In his letter, Azevedo identified several alleged shortcomings of the proposed STAX program.[18]

Azevedo criticized not only the STAX program, but other farm bill safety net proposals as going in the wrong direction by increasing trade-distorting subsidies. He also pointed out that none of the proposals seeks to change or end the GSM-102 program, which was faulted as a prohibited export subsidy in Brazil's challenge.[19] Whether this signifies real intent or is simply a negotiating

[17] Ibid.

[18] *Inside U.S. Trade,* "Brazil Blasts NCC Farm Bill Proposal, Says it Could Violate WTO Rules," February 6, 2012.

[19] *Inside U.S. Trade,* "Brazil Criticism Leads Senate Ag Chiefs To Seek Cotton Proposal Changes," April 18, 2012.

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strategy remains to be seen. It is noteworthy that, since former Ambassador Azevedo announced his candidacy for WTO Director General in early 2013 (a position he assumed on September 1, 2013), he has refrained from further comment on the Brazil-U.S. cotton case.

In response to Brazil's 2012 letter addressed to her, Chairwoman Stabenow argued that compliance with WTO rules is one factor that Congress must bear in mind. Moreover, she expressed confidence that the next farm bill will live up to U.S. WTO obligations. In contrast, House Agriculture Committee Chairman Frank Lucas expressed his fear that the new farm bill would increase trade-distorting subsidies by replacing direct payments, which are considered minimally trade-distorting, with other types of support schemes, although he made clear that this would not be an optimal outcome. According to Chairman Lucas, most agriculture groups he has dealt with thus far "don't seem to care that much about trade implications" of the next farm bill. "That's unfortunate, because we have to live for the next five years in the trade environment, in the WTO court, so to speak, with the decisions we make in this coming farm bill," he said.[20]

Potential Farm Bill Issues Remaining

A handful of issues related to the WTO cotton case, GSM-102, and STAX remain unresolved by either House or Senate farm bills. These include the following.

- GSM-102 still lacks a permanent "fix" and neither farm bill proposal addresses this issue.
- Because it is designed as an insurance product, STAX is not subject to any cap on individual payments (i.e., no payment limitation).[21] However, the Senate-passed farm bill contains a limit on crop insurance subsidies based on adjusted gross income (AGI)—subsidies are reduced by 15 percentage points if average AGI exceeds $750,000. This AGI limitation would likely apply to STAX if it is included in the final farm bill reported out of conference.
- The STAX payment rate multiplier of 120% available to producers seeking higher per-acre protection is poorly understood by casual observers. Brazil views this as a distortion.
- The government subsidy rate of 80% for STAX is more generous than for other insurance products, but is viewed by U.S. interests as a partial offset for the other program benefits sacrificed to obtain STAX.

U.S.-Brazil negotiations in this case remain ongoing and will likely hinge on the eventual farm bill treatment of cotton.

Is a Permanent Resolution in the Offing?

As stated earlier, the House- and Senate-passed farm bills are in conference. The proposed cotton policy changes were almost identical going into conference and were not likely to be part of the

[20] Ibid.

[21] The National Cotton Council (NCC) has suggested the possibility of limiting STAX payouts when futures prices are high relative to some established threshold but this is not part of either the House- or Senate-passed farm bills.

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give and take of conference policy negotiations. As a result, most of the cotton provisions discussed above are likely to appear as is in the final bill reported out of conference.

If this is the case, then the ball is clearly in Brazil's court. Under the WTO case ruling, Brazil has the authority to determine whether any U.S. policy changes are deemed sufficient to meet the conditions and/or terms of the said ruling. If the United States were to disagree with Brazil's interpretation of whether U.S. policy changes were sufficient, the United States likely would have to introduce a new dispute settlement case to the WTO or, alternately, reach some kind of new understanding with Brazil.

Cotton in WTO Trade Negotiations

An important consequence of the publicity associated with the Brazil dispute settlement case against U.S. cotton support programs was the response within the ongoing round of WTO multilateral trade negotiations, where cotton has been singled out for special consideration and treatment. As a result, these negotiations (both within the larger Doha Round negotiations, as well as the smaller Bali Ministerial texts) include provisions proposing that cotton receive special treatment under each of the three WTO negotiating pillars—domestic support, export competition, and market access.

Although the WTO's more comprehensive Doha Round so far has failed to finalize a new comprehensive trade negotiating agreement (with the exception of the Bali Ministerial agreement noted below),[22] if such an agreement were to be reached it would likely include specific provisions related to cotton which, in turn, could potentially impact U.S. cotton support programs and trade.

The C4 "Cotton Initiative"

In June 2003, four African countries—Benin, Burkina Faso, Chad, and Mali, referred to as the C4—presented a "Sectoral Initiative in Favour of Cotton" to the WTO Trade Negotiations Committee. Now referred to as the *Cotton Initiative*, the proposal highlighted the strong linkage that cotton has with least-developed countries (LDCs), as well as the damage that the C4 believe has been caused to them by cotton subsidies in wealthier countries. Their cotton initiative called for all cotton subsidies in developed countries to be eliminated and for compensation to be paid to the C4 while the subsidies remain in place to cover the related economic losses.

In response to the C4 proposal, a subcommittee was set up on November 19, 2004, to focus on cotton within the WTO's Committee on Agriculture (CoA).[23] About a year later, on December 22, 2005, the WTO's Hong Kong Ministerial Declaration included a commitment to address cotton "ambitiously, expeditiously and specifically" within the agriculture negotiations as follows:[24]

[22] See CRS Report RS22927, *WTO Doha Round: Implications for U.S. Agriculture*.

[23] As required in the August 1, 2004 decision—referred to as the "July Package"—covering all the WTO negotiations, WT/L/570, August 2, 2004. More information on the CoA's Cotton Sub-Committee, including all related WTO documents, is available at http://www.wto.org/english/tratop_e/agric_e/cotton_subcommittee_e.htm.

[24] Paragraph 11 of the Hong Kong Ministerial Declaration; 5th WTO Ministerial, WT/MIN(05)/DEC, Doha Work Program, adopted on December 18, 2005.

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- all forms of export subsidies for cotton by developed countries would be eliminated immediately upon implementation of a new trade agreement;
- developed countries would give duty-free, quota-free (DFQF) access for cotton exports from least-developed countries (LDCs) immediately upon implementation of a new trade agreement; and
- trade-distorting domestic subsidies for cotton production would be reduced more ambitiously than under whatever general formula is agreed to for other commodities, and it should be implemented over a shorter period of time than generally applicable.

However, the Doha Round negotiations floundered and, in December 2011, at the WTO's 8th Ministerial meeting in Geneva, were declared at an impasse and members were directed to explore new negotiating approaches.[25]

Cotton at the Bali Ministerial

The next opportunity to address the "Cotton Initiative" was the Bali Ministerial of December 3-6, 2013. The C4 had presented a new rewrite of their earlier proposal to the Trade Negotiations Committee on October 25, 2013, just in advance of the Bali Ministerial. In their new proposal, the C4 proposed reforming cotton trade in two stages:[26]

- *At the Bali Ministerial*, ministers would agree to (1) grant duty-free, quota-free (DFQF) access to developed-country markets from January 1, 2015, and (2) immediately eliminate any remaining export subsidies on cotton.
- *After the Bali Ministerial* (but with agreement in Bali to do this), domestic support for cotton would be negotiated intensively in 2014 in order to reach agreement by the end of the year on substantial reductions.

WTO negotiating committees decided that the new C4 proposal was presented too close to the Bali Ministerial to allow for proper vetting. Instead, the cotton text that was included in the final Ministerial Decision represented a compromise. Specifically, the final Bali cotton text agreed to as part of the Ministerial agreement:[27]

- reiterated WTO members' commitment to make progress in the negotiations on cotton according to the 2005 Hong Kong Ministerial objectives;
- officially expressed regret that no progress had been made to date;
- committed to meet twice each year to study the latest information and discuss developments regarding the cotton initiative; and
- re-affirmed the importance of cotton to lesser-developed countries (LDCs) and the need to strengthen development assistance for the cotton sector in LDCs.

[25] *Bridges Negotiation Briefing*, Special Bali Issue, December 2013; available at http://ictsd.org/downloads/bridgesweekly/bridgesweekly17-40.pdf

[26] WTO: 2013 News Items, "Texts: Cotton producers release proposal for Bali and chair updates members on farm talks," October 30, 2013; at http://www.wto.org/english/news_e/news13_e/news13_e.htm.

[27] WTO, Ninth WTO Ministerial Conference; available at https://mc9.wto.org/.

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Why Does This Matter?

The special treatment of cotton within the WTO's current round of trade negotiations has served to highlight, and bring into international focus, the Brazil-U.S. cotton policy case and proposed changes to U.S. farm programs for cotton. Such heightened international awareness could intensify pressures on both Brazil and the United States to resolve the cotton dispute in a transparent and widely acceptable manner so as to minimize further repercussions.

Conclusion

While a new farm bill might address issues related to the WTO Brazil-U.S. cotton case from a U.S. perspective, Brazil still retains substantial authority in making a final determination regarding the compliance of any policy changes to U.S. cotton support programs. Furthermore, the heightened attention surrounding the WTO Brazil-U.S. cotton case has served to single out cotton for special treatment within ongoing WTO trade negotiations. A final resolution to the cotton case could have an important bearing on how cotton support programs are treated in future WTO trade negotiations or in future dispute settlement cases.

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