

Addressing Global Cotton Subsidies: Uprooting the seeds of poverty in Hong Kong and beyond

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Executive Summary	2
List of Acronyms	5
1. Introduction.....	6
2. Cotton in the developing world – why distortions matter.....	10
2.1. The importance of cotton	10
2.2. Recent trends in cotton prices and subsidies.....	12
2.3. Linking subsidies, declining prices and lost earnings.....	14
3. What’s being done?.....	20
3.1. The Cotton Initiative	20
3.2. Dispute Settlement – Brazil versus the US	24
3.3. Financial assistance.....	32
4. What’s not being done?	38
4.1. Subsidy reduction.....	39
4.2. Compensation and financial assistance.....	42
4.3. Dispute Settlement	44
4.4. Systemic commodity issues	47
5. Looking ahead to Hong Kong.....	52
5.1. What can be achieved in Hong Kong?.....	53
5.2. If nothing in Hong Kong – then what?	55
6. Tables and Figures	56
7. Bibliography	59

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Executive Summary

International trade in cotton exemplifies the tilted playing field against developing countries in the context of agriculture. On the one hand we find some of the poorest (West and Central Africa) and largest (Brazil, China and India) developing countries in the world holding a competitive advantage in the production of raw cotton, while on the other, we have the US and EU spending billions of dollars annually in subsidies to prop up an otherwise inefficient and high-cost sector.

The pernicious impacts of these continued subsidies are now well established – resulting in depressed world cotton prices, lost market share for otherwise competitive producers and the concomitant loss of hundreds of millions of dollars in forgone export earnings. What remains a matter of intense debate however is exactly how, when, and where the impact of these subsidies should be addressed.

These questions are particularly germane with respect to the commitment made in Doha by the international community – and in particular the major OECD trading powers – to placing development at the centre of the trade agenda. So much so, that many observers have now come to view a solution to the imbalance in the cotton sector as a litmus test of the ability of the multilateral trading system to focus its attention on the needs of its most vulnerable Members.

Being at the doorstep of the 6th WTO Ministerial Conference in Hong Kong, the question is all the more timely as to what, if anything, the major trading powers are prepared to deliver on cotton in the context of the Doha Development Agenda.

We argue here that while the successful challenge to US subsidies may help deliver on some of the reform objectives (as contained in the Cotton Initiative) neither of the current paths of negotiation litigation or appear poised to deliver meaningful reductions in support to inefficient producers in the short-term. While financial assistance is welcomed, both to enhance the competitiveness of low-cost producers and assist in their efforts at export diversification, it would not seem helpful if it

obfuscates from the needed reforms, nor should it be viewed as a substitute for compensation of injury pending the reform of support programmes.

In light of the slow pace at which deep reforms to the cotton sector are likely to occur – predicated as they are on the overall agricultural negotiations – we underscore the importance of putting some type of compensation mechanism back on the trade agenda (irrespective of whether it is delivered via a WTO mechanism).

Outside the WTO, the resources being allocated for financial assistance must be greatly enhanced if they are to effectively fill the chronic savings/investment gap that exists in most Africa cotton producing countries. In addition, if the global community is serious about helping create an environment conducive to competitive developing country cotton producers trading their way out of poverty, certain issues endemic to primary commodities (and its dependence) will also have to be addressed.

Specifically for Hong Kong , if substance is to be put to the ‘Doha Development Agenda’ rhetoric, we emphasise that at a minimum there should be concrete and binding commitments to mechanisms aimed at operationalising the mandate to address cotton “ambitiously, expeditiously and specifically” (irrespective of any ‘recalibration’ elsewhere in the negotiations). Should explicit numbers and dates not be feasible at this time, some degree of modalities ensuring an accelerated treatment of cotton (predicated on a baseline to be agreed in the future) should be pursued to serve as a foundation for future discussions.

Possible items for consideration include:

- Duty- and quota-free market access for cotton and related by-products for LDC net-cotton-exporters;
- A structure around which specific dates can be agreed upon in the future that binds an accelerated elimination/reduction of trade-distorting domestic support and export subsidies;

- Agreement – at least in principle – on the future development of mechanisms to ensure the reduction/elimination of cotton subsidies is meaningful and not simply an exercise in ‘box-shifting’;
- Agreement that with respect to cotton, the base year for reduction commitments will not be 1999/01 (or 1995-00), but rather structured to ensure that cuts are based a lower, more historically representative level of support (thereby helping to ensure real and meaningful cuts in the level of current support materialise);
- Finally, in light of the injury to competitive cotton producers that is likely to persist into the medium-term pending the elimination of distortions in global cotton trade, agreement to recommence discussions at the WTO on options for a temporary compensation mechanism – as distinct from financial assistance – (even if it were to be agreed *ex ante* that such compensation would be delivered outside the WTO framework).

Should nothing of real benefit materialise for cotton reform in Hong Kong, the proponents of the Cotton Initiative have indicated that a bad deal on cotton implies no deal at all. Should that be the case, dispute settlement remains at their disposal. Ironically, with the disastrous negotiating outcome upon which this course of action would likely be based, the environment could be ripe (in light as well of the expired Peace Clause) for a wide range of challenges to US and EU subsidies – cotton and otherwise.

List of Acronyms

ACP – African, Caribbean and Pacific Group of States
AoA – Agreement on Agriculture
ASCM – Agreement on Subsidies and Countervailing Measure
ATC – Agreement on Textiles and Clothing
CA – comparative advantage
CDDCs – commodity-dependent developing countries
DSB – Dispute Settlement Body
DSU – Dispute Settlement Understanding
EBA – Everything But Arms
EU – European Union
FAO – Food and Agriculture Organisation of the United Nations
GATT – General Agreement on Tariffs and Trade
GATS – General Agreement on Trade in Services
GSP – Generalised System of Preferences
ICAC – International Cotton Advisory Committee
IF – The Integrated Framework for Trade-Related Technical Assistance to LDCs
IFIs – International Financial Institutions
LDC – Least Developed Countries
MFN – most favoured nation
MY – marketing year
NTBs – non-tariff barriers
ODA – Official Development Assistance
OECD – Organisation for Economic Cooperation and Development
R&D – research and development
SDT – special and differential treatment
SSA – Sub-Saharan Africa
TRIPs – Trade-Related Aspects of Intellectual Property Rights
UNECA – United Nations Economic Commission for Africa
UNCTAD – United Nations Conference on Trade and Development
UNIDO – United Nations Industrial Development Organisation
US – United States of America
USDA – US Department of Agriculture
USTR – US Trade Representative
WCA – West and Central African
WHO – World Health Organisation
WTO – World Trade Organisation

1. Introduction

Having come to the fore in international trade and development debates in 2002 with the Brazilian request for consultations on US cotton subsidies and the 2003 WTO proposal by Benin, Burkina Faso, Chad and Mali for a ‘Sectoral Initiative on Cotton’, international trade in cotton exemplifies the tilted playing field against developing countries in the context of agriculture. On the one hand we find some of the poorest (West and Central Africa) and largest (Brazil, China and India) developing countries in the world holding a competitive advantage in the production of raw cotton, while on the other, we have the US and EU spending billions of dollars annually in subsidies to prop up an otherwise inefficient and high-cost sector. The pernicious impacts of these continued subsidies are now well established – resulting in depressed world cotton prices, lost market share for otherwise competitive producers and the concomitant loss of hundreds of millions of dollars in forgone export earnings. What remains a matter of intense debate however is exactly how, when, and where the impact of these subsidies should be addressed.

With the latest round of multilateral trade negotiations launched in Doha in 2001 (and the first under the auspices of the WTO), the international community – and in particular the major OECD trading powers – made a commitment to placing development at the centre of the trade agenda. Having already passed the original 1 January 2005 completion date however, what has been termed by some observers the ‘Doha Development Agenda’ has seen slow progress to date, including the failure in September 2003 to find consensus at the Cancun Ministerial Conference¹. As with the Uruguay Round negotiations (which lasted seven and a half years, twice what was envisaged), the area of agriculture has proved particularly troublesome.

Both before and after Cancun – and seemingly again now in Hong Kong – the area of cotton trade has figured high in the WTO’s agenda. Indeed, with the persistence of such a clear imbalance in the sector, many observers view cotton as a litmus test of

¹ Two key areas of divergence in Cancun were agriculture (including cotton) and the basket of ‘Singapore Issues’ (which included investment, competition, transparency in government procurement, and trade facilitation). See ICTSD 2003 for coverage of the collapse in Cancun.

the ability of the multilateral trading system to focus its attention on the needs of its most vulnerable Members.

Notwithstanding the broader push to facilitate developing countries capturing a greater portion of the potential gains from international trade, the essential role of cotton in the growth and poverty alleviation prospects of many of its producers implies that concrete action is urgently required. As such, with the 6th WTO (Hong Kong) Ministerial Conference approaching in December 2005, the question remains as to what, if anything, the major trading powers are prepared to deliver on cotton in the context of the Doha Development Agenda.

In this regard, one of the fundamental questions to be answered is whether those countries whose support to the cotton sector is most distorting (i.e. the US and the EU) will pursue meaningful domestic reform to mitigate the harm caused to otherwise competitive cotton producers, or, whether they will seek to avoid such reform through, for example, the offering of an attractive financial package aimed at generating support for effectively carrying on 'business as usual'. Furthermore, the matter of compensating those injured pending such reforms (especially those least capable of mitigating the damage caused) must be addressed.

With respect to subsidies, with the 'trade aspects' of cotton having been subsumed into the broader agricultural talks, meaningful progress will be predicated on significant movement in across-the-board reform – upon which deeper cuts in cotton can be pursued. While the implications of this are that reform is likely to be slow-moving, the successful Brazilian challenge to US subsidies may elicit some of the objective sought after by the Cotton Initiative (although doubts have been raised as to the degree to which Brazil will pressure the US to comply with aspects of the ruling prior to mid-2006). With most Members having scaled back expectations for Hong Kong, the unfortunate reality would indicate that significant support to inefficient cotton producers (and the associated injury to competitive producers) will continue for some time into the future.

For this very reason, the complimentary issue of compensation should return to the WTO agenda, both in terms of compensation for continued injury to those producers

least capable of mitigating the harm resulting from depressed cotton prices and lost market share, as well as to serve (at least in principle) as an additional incentive and reminder of the responsibility of the offending subsidisers to reform their distorting ways. While the proposed ‘financial assistance’ from the donor community is an important part of the broader support to cotton producing countries from the international community (irrespective of existing distortions in the cotton market), it is not a substitute for compensation.

This is not however, intended to absolve in any way the responsibility of the US and EU to confront their domestic cotton interests and undertake the often difficult domestic reforms that developing country WTO Members are well-versed in. While a range of international technical and financial efforts – both to compensate injured cotton producers and support export diversification – surely form some part of the solution, reducing the distortionary effects of cotton subsidies in both the US and EU cotton markets are a *sine qua non* for effectively mitigating the damage rendered. Without this, developing country cotton producers will not be able to maximise the benefits of their competitive advantage in cotton. Should the required reforms seem unattainable in a reasonable timeframe via the negotiations, the LDC net-exporters may want to consider the option of taking the offending parties to a dispute panel.

Finally, if substance is to be put to the ‘Doha Development Agenda’ rhetoric, concrete action on cotton is required in Hong Kong (irrespective of any ‘recalibration’ elsewhere). At a minimum, this includes a structure to ensure the elimination of all trade-distorting cotton support measures occurs on an accelerated timeline, and agreement (at least in principle) on the development of mechanisms to ensure the reduction is meaningful and not simply an exercise in ‘box-shifting’. In parallel, Members need to accept responsibility for the injury that will be caused to competitive cotton producers pending the elimination of distortions in cotton trade and should agree to recommence discussions under the auspices of the WTO for such provision (even if it were to be agreed *ex ante* that such compensation would be delivered outside the WTO framework).

Since the Seattle Ministerial it has become increasingly clear that the voice of smaller actors in the multilateral trading system cannot be ignored. In that an effective

solution to the cotton issue is a necessary (albeit perhaps not sufficient) condition for the broader consensus to be sought on 13-18 December, Hong Kong should be no different.

The structure of the paper is as follows. Section two offers some background on cotton, highlighting its importance in developing countries and reviewing the existing literature confirming the links between cotton subsidies, recent price trends and the injury of lost export earnings for competitive producers. Section three delves into what is currently being done to address distortions in cotton trade, including a review of the West and Central African (WCA) 'Cotton Initiative' and the WTO dispute ruling, as well as the 'financial assistance' initiative outside the WTO. Flowing from the discussion here on the unsatisfactory progress so far, the fourth section moves to consider areas for potential improvements within existing initiatives, as well as touching on other systemic difficulties related to commodity dependence requiring attention. We close with comments and recommendations regarding cotton in the context of the forthcoming Hong Kong WTO Ministerial Conference in December 2005.

2. Cotton in the developing world – why distortions matter

With the scale and scope of cotton production in developing countries – in which two-thirds of global production occurs – the importance of cotton trade to their growth and poverty reduction prospects cannot be overstated. By extension, neither can the damage engendered by subsidies and domestic support. Indeed, alongside the magnitude of support to Northern cotton farmers, one of the key reasons such attention has been focussed on the sector stems from the essential role it plays in many of its developing country producers. We review some production and price trends below before turning to recent studies linking subsidies to depressed cotton prices and lost export earnings. With the clear linkage between US and EU subsidies causing meaningful injury to competitive producers, and the fact that many of these producers are some of the lowest-income countries in the world (for which cotton is a vital cash crop), we emphasize that the unique nature of the problem facing the global cotton sector warrants concrete action in the short term.

2.1. *The importance of cotton*

Despite fairly stagnant global demand for cotton (due in part to synthetic substitutes and the rising productivity of certain producers) global cotton production has grown at almost 2 percent annually over the past 40 years, doubling from just over 10 million tonnes in 1960 to 20 million in 2001 (Baffes 2004). In terms of value, both relative to other agricultural activities and as a source of income in developing countries, it stands as the highest earning non-food crop globally and has been estimated to employ seven percent of all developing country labour, largely in smallholder farms (Clay 2004). Indeed, much of the growth in global production is attributable to large increases in production in developing countries, including traditional producers such as India, China and Pakistan, as well as new entrants such as WCA² (Baffes 2004).

² Cotton producers in WCA for which cotton comprised at least 1 percent of GDP in 2000 include Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Côte d'Ivoire, Ghana, Guinea, Mali, Senegal, and Togo (Fortucci 2002).

In the latter group for example – which include some of the lowest-income countries in the world – cotton production has risen from just over 100,000 tonnes in the early 1960s to over 1.1 million tonnes in 2002 (Gillson et al. 2004). As such (based on production volume), they have become the 6th largest producer after China, the US, India, Pakistan, and Uzbekistan. Accounting for 13 percent of world exports in 2001/02, they are on par with Uzbekistan as the 2nd largest exporter after the US (who commands 37 percent of exports) (Goreux 2004b). This latter standing is somewhat misleading in absolute terms however, as WCA ranks high in terms of exports due to the fact that a number of the larger cotton producers do not export their production, but rather consume it in domestic textile industries (e.g. China, India, and Pakistan). Thus in absolute terms of production volume, they are in fact still a marginal player, accounting for between 10-15 percent globally (Gillson et al. 2004).

WCA's smallness in global comparison however does not diminish the importance of cotton domestically. On the contrary, its relative economic importance is far greater, accounting for between 5-10 percent of GDP, more than a third of the value of export earnings and over two-thirds the value of agricultural exports (ibid). Cotton has been estimated to employ over 6 million people in the region (UNCTAD 2005) and due to the use of manual harvesting techniques, has resulted in good quality fibre delivered at highly competitive costs.³ In light of the low labour costs involved, these countries are believed to hold a comparative advantage in cotton production (Goreux 2004a). Expanded cotton production from 1993-98 has also been attributed to significant health and poverty reduction improvements in WCA cotton growing areas, wherein incidences of poverty declined from 50 to 42 percent, as opposed to a two percentage point increase in non-cotton-producing rural areas (Goreux 2004b). With such a fundamental role to the livelihoods and well-being of these countries, it comes as no surprise that these countries (as we shall see below) are pushing for an expedited track in the negotiations to address specific distortions.

Cotton production also plays an important role in other areas of the developing world. India, for example, accounted for approximately 10 percent of global cotton production in 2002 (ranking 3rd globally with 1.9 million tonnes) (Gillson et al, 2004).

³ Despite difficulties in comparing costs across countries, a 2001 ICAC study ranked WCA amongst the lowest cost cotton producers globally (alongside Uganda and Tanzania).

Due however to their large textile sector, exports were negligible – and thus the depression of global cotton prices of lesser significance. This was less the case with neighbouring Pakistan, who accounted for 9 percent of global production the same year (ranking 4th globally with 1.7 million tonnes), but for whom, in 2000, cotton exports amounted to almost 15 percent of the value of all agricultural exports (Fortucci 2002).

Cotton production and export is a significant economic activity elsewhere in Africa as well, such as Tanzania, Zambia, Mozambique and Uganda – although declining in importance in some regions, while increasing in importance in others. Despite a decline in relative importance since the 1980s in the United Republic of Tanzania and Zambia, raw cotton exports still accounted for 6 percent and 27 percent respectively of the value of all agricultural exports in 2000 (ibid). For others in the region, the trend ran in the other direction, with cotton exports taking on relatively greater importance over the twenty year period, rising as a share of the value of all agricultural exports in 2000 from 5 to 14 percent in Mozambique and from 1 to 7 percent in Uganda.

2.2. Recent trends in cotton prices and subsidies

Looking at historical price trends⁴, in 2003/04, Baffes (2004) notes that real cotton prices (i.e. cotton prices in constant dollar terms) were one fifth of their 1950 level.⁵ Taking into account various price data sources and previous studies on commodity price trends, Razzaque et al. (2004) find a declining price trend rate of approximately 2.5 percent over the 1960-2002 period, with greater volatility over the past two decades. Echoing the latter point, Baffes (2004) points out that cotton price volatility has been twice as high since 1985 as compared to pre-1973, finding a structural break at the start of the recent period of increased volatility, which coincides with the 1985

⁴ The most widely used cotton price measure is the 'Cotlook A Index', which provides an average (in US\$) of the five lowest offering prices traded in North European ports for 16 styles of cotton (all of the Middling 1-3/32 inch fibre length grade). As such, all cotton prices used will be in terms of the Cotlook A Index (hereafter A Index).

⁵ Of note, this decline would have been even more pronounced were it not for a 34 percent increase in 2002/03, after cotton prices reached historic lows in 2001/02. This upswing was stimulated primarily by a poor 2002/03 crop in China and the resulting increase in global demand, however the ICAC (2005) projected a 22 percent decline for 2004/05 after a 6-year high the previous season.

change in the US support programme from stockholding (i.e. supply management) to price support. Indeed this latter observation foreshadows the relationship found in recent literature between the US cotton support programme and price movements. Figure 1, showing annual A Index prices in both nominal terms (i.e. current US dollars) and real terms (i.e. constant 2000 US dollars⁶), offers a picture of both the downward trend and the heightened post-1985 volatility.

Numerous factors lie behind recent price movements. These include erratic changes in production and exports from India, Pakistan and China (where high levels of production, usually bound for domestic textile sectors, have at times found their way to export markets); reductions in the cost of production (a combination of technological innovations resulting in yield improvements and decreased transportation costs, as well as sectoral reforms); and competition from synthetic substitutes (where declining prices in the late 1990s, resulting in part from the impact of the Asian financial crisis on producers in the region, placed downward pressure on the demand and price of cotton (Baffes 2004; Gillson et al. 2004). Another key factor placing downward pressure on cotton prices in recent years has been the large increase in subsidies⁷ to cotton producers, which (as we shall see below) facilitated levels of production and exports that did not reflect their cost realities, thereby inducing excess supply and helping to lower global prices (Sumner 2003; Goreux 2004b; Gillson et al. 2004).

Depending on what is taken to constitute a subsidy (see footnote 7), estimates of annual government support to the cotton industry worldwide have ranged from US\$ 3.8 to 6 billion for the 1997/98 to 2001/02 period (Baffes 2004; ICAC 2005). In terms of absolute support, the US provides the highest level (averaging US\$ 2.5 billion annually; 1997/98-2001/02), followed by China (US\$ 1.2 billion in 2001/02) and the EU (US\$ 0.8 billion in 2001/02) (Baffes 2004). Being by far the largest

⁶ Real prices were calculated using the US Bureau of Economic Analysis GDP deflator with 2000 as the base year.

⁷ In practice governmental support is disaggregated between 'domestic support measures' and 'export subsidies', the former of which have traditionally been viewed as less price distorting than the latter. However, it is commonly believed, and indeed confirmed by the recent WTO ruling (at least vis-à-vis cotton), that domestic support can also result in meaningful price distortions and injury to other producers. As such, for our purposes here, we shall use the terms interchangeably (unless otherwise specified). We note however that the lack of consensus over defining what constitutes a subsidy (distorting or otherwise) has resulted in different studies reporting different figures in this area.

exporter, US subsidies exert the strongest influence on world prices, followed by the EU, which offers the highest per unit support (nearly twice that of the A Index price in 1995/96 to 1999/00). The impact of Chinese subsidies on world prices depends largely on whether it finds itself in a position of net importer (pushing prices higher) or net exporter (depressing prices), for which, since the 1980s, it has been slightly more often the former. Indeed, as noted above, the 2002/03 price rise was largely attributed to a poor Chinese crop (and consequently higher imports to meet the demands of their textile sector).

Putting these figures (and their recent growth) into perspective, whereas 50 percent of traded cotton was already subject to subsidies in 1997/98, this figure increased to 75 percent in 2000/02 (Goreux 2004b). By 2001/02, direct annual support alone as a percent of the Index A price reached 75 percent in the US and 187 and 253 percent in Greece and Spain respectively (Baffes 2004). US support that season, estimated at US\$ 3.9 billion, totalled three times the amount of the US' entire USAID budget for Africa in the same year (Oxfam 2002).

2.3. Linking subsidies, declining prices and lost earnings

Despite important differences between them⁸, numerous recent studies estimating the impact of cotton subsidies (primarily US and EU) on cotton prices and/or the export earnings of other cotton producers have confirmed the relationship between cotton subsidies, depressed cotton prices and lost export earnings. With respect to increases in cotton prices resulting from the removal of subsidies, the estimates generally range between 3 and 30 percent. In the more limited subset of studies directly addressing lost export earnings, the injury to WCA producers (the group most commonly treated) tends to fall within a US\$ 30 to 260 million dollar range.⁹ We note that while estimation techniques are fraught with subjective judgements and parameter values that prevent definitive results (for example the difficult task of judging the capacity of

⁸ For example, the definition of subsidies (and hence the level of support accounted for), base year for levels of production and governmental support, market structure, demand and supply elasticities, and estimation model employed.

⁹ For those studies that do not themselves consider forgone earnings, FAO (2004) uses a supply response equation for WCA to offer a rough calculation of their forgone export earnings.

producers to change supplies in response to global price changes; i.e. their price elasticity of supply), they do offer a sense of the magnitude to which cotton subsidies distort global cotton markets and harm other producers.

An exhaustive review of the literature lies outside the remit of the current paper – and has to a large extent already been covered in FAO (2004)¹⁰ – and so we briefly consider here three influential and important studies. The first, which was used by Brazil to support their WTO dispute case, is provided by Sumner (2003), who estimates the impact of various elements of the US cotton support programme on world cotton prices. The other two, offering estimates on both price changes and forgone earnings include that by Goreux (2003/2004) which underpinned the WCA WTO proposal and a recent study by Gillson et al. (2004) that builds on the Goreux model but allows for scenarios based on different market segmentation and elasticity assumptions. The latter is particularly interesting both in its attempts to better approximate the conditions and dynamics of global and domestic cotton markets, as well as in offering estimates of forgone earnings for countries outside WCA.

In his 2003 study, Sumner considers the production and price effects from the removal of all US subsidies. To do so, he bases his work largely on the Food and Agricultural Policy Research Institute (FAPRI) policy modelling framework, which is a multi-market, world agricultural model widely employed by governmental and international researchers to model the impacts of trade liberalisation. Notably, this framework forms the basis of work undertaken by the USDA to determine (and market) the beneficial impact of the 2002 US Farm Bill to the domestic cotton industry. Of interest to the Brazilian WTO challenge (to which we return in more detail below), Sumner's disaggregated approach allows him to identify the specific distortionary effects of the various elements within the complex US support programme (see Table 1 below). On aggregate however, for the marketing periods of 1999-2002, Sumner finds that the removal of all US production and export subsidies would have resulted in an average 12.6 percent increase in the world A Index price. Over the longer period of 1999-2007, the price increase would have been slightly lower, averaging 11.6 percent.

¹⁰ Tables 2 and 3 below, sourced from FAO (2004), offer a glimpse at the key conclusions and assumptions relating to the major econometric studies undertaken.

This estimate is broadly in line with that derived by Goreux (2003), which serves as a background document to the WCA WTO submission. In it, Goreux employs a partial equilibrium model to simulate prices that would have prevailed over the 1997/98-2001/02 period in the absence of subsidies in the US, China, Greece and Spain (the latter two taken to represent EU cotton support). In his initial paper, (based on the demand and supply elasticities commonly employed in ICAC analysis) Goreux (2003) estimated an average 12 percent increase in cotton prices over the five year period. While his initial study saw an annual peak of 15.2 percent in 1999/00 during that period, his revised 2004 paper (based on newly available subsidy data) estimated a 17.6 percent price increase in 2001/02 in the absence of subsidies (as opposed to the 13.3 percent estimated for that season in the original study).

In terms of translating this into estimations of lost export earnings, despite similar shortcoming noted above for estimating price changes, Goreux (2003) estimated lost export earnings to WCA cotton producers at US\$ 250 million in 2001/02 and an average annual loss of US\$ 200 million over the previous five years. The losses from US subsidies alone, he calculates, represent between 30 and 40 percent more than the US ODA received by these four LDCs combined (Goreux 2004a). Of note however, the estimated losses are based on the initial subsidy data available and not the higher levels which were noted in the revised 2004 version of his paper (2004b). As such, it should be taken as a conservative estimate.

In the Gillson et al. (2004) study, the authors attempt to better approximate different real world market conditions by developing four scenarios which distinguish between a single world cotton market and a perfectly fragmented market, as well as between uniform and differentiated supply elasticities between producers. In taking such an approach, this study is able to account for the heterogeneity in the quality of raw cotton supplied to the international market (and thus the different price dynamics) as well as the varying capacity of different countries/producers to respond to price changes. Subjective assumptions notwithstanding, they estimate that the removal of all cotton subsidies globally in 2001 would increase world cotton prices in the range of 18 to 28 percent, with the low end coming under a single world cotton market with homogenous supply elasticities across countries (as used in most other studies) and

the upper figure arising in a world where cotton user cannot switch between suppliers (i.e. a perfectly fragmented market) and different producers are capable of different supply responses to global price changes. Based on their qualitative assessment of both the demand conditions for cotton importers (i.e. the ‘stickiness’ of cotton trade flows) and the factors affecting the supply capacity of different cotton producing countries, they conclude that of the four scenarios, “the cotton market is probably more fragmented in the short term than in the long term, so our preferred simulation of the final impact would be ... [that of] a single market but with higher supply elasticities for WCA.” (p. 65).

In terms of direct earnings forgone resulting from the removal of subsidies in 2001 (under their various market assumption scenarios), they find that WCA would have gained between 10 and 37 percent of additional earnings that year, with the preferred scenario highlighted above suggesting the upper end of the spectrum. Such percentages would translate into additional export earnings in the range of US\$ 94 million dollars to 360 million for this group of countries. Rare in their offering of estimated losses for other major cotton producing countries, Gillson et al. posit a gain of between 5 and 36 percent for India and 3 and 36 percent for Pakistan. Along with these two countries, the bulk of the gains from subsidy removal would also be captured by Australia, Brazil and Turkey, ranging on aggregate from 68 to 73 percent of the total available gains. With such gains potentially available to these non-WCA countries, they would be well placed to support the efforts of these small African producers to elicit a meaningful package of reform from the major subsidising countries.

Another noteworthy outcome from the Gillson et al. study relates to their estimates of the influence on global prices by individual subsidising countries. By nature of their size alone, it has long been perceived that US cotton subsidies impart the greatest injury to other cotton producers. However, by disaggregating the impact of individual country subsidies, their study posits that EU subsidies, relative to their absolute level of support, cause disproportionate harm to WCA producers in terms of lost earnings. We note however the sensitivity of these results to the assumptions of market segmentation, with the losses attributable to EU subsidies jumping at least 30% when assuming that cotton users cannot easily change suppliers. While the assumption of

perfect market segmentation is clearly unrealistic and serves illustrative purposes in the study, the implications still hold that EU subsidies cannot be overlooked when considering what is needed to reform the global cotton market.

It is also important to note that the estimates above are exclusively direct losses resulting from forgone cotton trade and do not account for the indirect impact that this important commodity has throughout the countries that produce them. Such effects would be particularly important for those countries most dependent on cotton production – such as the WCA producers. Due to the difficult nature of estimating indirect impacts (resulting from insufficiently disaggregated consumption data), few studies have attempted it. One exception is a study by Minot and Daniels (2002) on the poverty impacts of cotton subsidies on Benin. In it, they attempt to estimate the indirect effects of a 40 percent price drop to non-cotton producers by calculating the marginal propensity of cotton producers to consume tradable goods (i.e. their reduced domestic demand). They conclude that for every dollar reduction in cotton producers' income there is a 3.3 dollar contraction in overall demand. As noted by Goreux (2004b) however, in the WTO context, both in terms of the dispute settlement process and any attempted calculation of compensation due to injury, only direct losses are relevant. In addition, with regards to the latter, the injection of compensation into the economy (assuming it was transmitted to cotton producers) would carry similar indirect effects.

The discussion above highlights the fact that cotton remains an essential component of the development trajectory for numerous developing countries. As such, the relative impacts resulting from distortions in the market are disproportionately borne by them, many of which are some of the lowest income countries in the world, yet at the same time amongst the most competitive cotton producers. Despite important methodological differences between the numerous studies estimating the impact of US and EU cotton subsidies, it is clear that they have depressed prices, resulting in meaningful income losses, exacerbated incidences of poverty and diminished capacity to maximise the benefits of their comparative advantage. In sum, the combination of these factors should place the cotton issue at the top of the global agricultural trade reform agenda – however the reality on the ground would indicate that beyond the

realm of rhetoric, this is not taking place. It is to these considerations of what is currently being done to address this heavily distorted sector that we now turn.

3. What's being done?

To date, the specific efforts at addressing distortions in global cotton trade have occurred along two main tracks – one within the WTO and one outside. The former includes what has been termed the ‘trade aspects’ of the Cotton Initiative (i.e. the subsidy elimination elements), as well as the successful Brazilian challenge to US cotton subsidies. Outside the WTO, efforts have focussed on the ‘development assistance aspects’, which has erroneously been equated with the compensation dimension of the Cotton Initiative and has largely been conducted as a discussion between African cotton producers and the development/donor community. A review of each of the the prongs below helps to elucidate their respective objectives, consider the progress achieved to date, and assess the potential for the current trajectory to effectively address the key challenges at hand. In doing so, this allows us in the following section to consider areas for potential improvements, including specific measures that could be taken in Hong Kong and beyond.

Specifically, while the successful challenge to US subsidies may help deliver on some of the reform objectives (as contained in the Cotton Initiative) neither of the current paths of negotiation litigation or appear poised to deliver meaningful reductions in support to inefficient producers in the short-term. While financial assistance is welcomed, both to enhance the competitiveness of low-cost producers and assist in their efforts at export diversification, it would not seem helpful if it obfuscates from the needed reforms (on the contrary it could exacerbate the harm), nor should it be viewed as a substitute for compensation of injury pending the reform of support programmes.

3.1. The Cotton Initiative

Having been brought to the WTO in April 2003 as part of the lead-up to the Cancun Ministerial Conference by Benin, Burkina Faso, Chad and Mali, the ‘Cotton Initiative’ was launched due to a sense by the West and Central African proponents that the circumstances surrounding cotton trade deserved a separate and expedited

track in the latest ‘development’ round of trade negotiations. As touched on earlier and supported by the discussions above, this view was based on the fact that their comparative advantage in cotton – a commodity that is paramount to the welfare of a small group of some of the lowest income countries in the world – was being undermined by the subsidies provided by two of the greatest champions of the fruits of comparative advantage-based trade liberalisation, the US and EU¹¹. With such a stark imbalance evident, a specific intervention on cotton, like the intervention on TRIPs and public health issue that surfaced in Doha¹², seemed well placed to press the major trading powers to take the ‘development agenda’ seriously.

Citing the elimination of cotton subsidies as “the only specific interest of WCA cotton-producing countries in the Doha round” (WTO 2003a), the proponents called for i) a mechanism to phase out, with a view to eliminating, all support for cotton production; and ii) transitional financial compensation to offset the resulting injury (i.e. forgone earnings) during the period of elimination. As detailed in their August 2003 submission (WTO 2003b), the specifics of their proposal (or ‘modalities’) outlined a three year implementation period for the elimination of all production and export support to cotton, which was initially envisaged to begin in 2004. More recent proposals (e.g. WTO 2005a by the Africa Group) differentiated between domestic support and export subsidies, calling for a slightly longer phase-out period for the former (which are more politically sensitive, especially in the US where they form the bulk of expenditures).

With regards to compensation, the proposed ‘stop-gap’ emergency measure was intended as a temporary mechanism both to offset the injury caused by continued cotton support in the main subsidising countries and to provide an additional incentive to those countries to reduce their support expeditiously. The amount of compensation requested was based on the estimated direct losses suffered by LDC net-exporters in the 1999/2000 to 2001/02 seasons, wherein based on the initial study by Goreux (2003) noted earlier, the proponents requested approximately US\$ 250 million per

¹¹ Based on WTO convention, the European Union (EU) is referred to by its previous name, the European Communities (or EC), however for sake of consistency, we will continue to refer to the EU.

¹² See ICTSD (2002) for a review of the TRIPs and public health issue at Doha.

annum.¹³ Contributions would be based on a country's respective share in the total amount of global cotton subsidies provided and would decrease proportionately with the reduction/elimination of support. The allocation of compensation would be determined on the basis of shares of total cotton production within the group of recipient countries. It would be disbursed, wherever possible, via local producer associations so as to help ensure it enabled producers to maintain production in the face of depressed world prices and encourage competitiveness-enhancing investments.

Structured as such, the proposals seemed to effectively address the two core problems of continued subsidisation of uncompetitive cotton producers in the US and EU and the resulting injury to the most vulnerable, yet competitive, LDC net-exporting producers. The responses from the major trading powers however – both at and after the Cancun Ministerial – were lukewarm at best (Oxfam 2004b), especially with regards to compensation. As opposed to accepting the need for domestic adjustment and compensation for injury, the subsidising countries (led mostly prominently by the US) called for LDC producers to diversify their economies. This was taken as an affront to both the LDC producers as well as the principles of trade liberalisation to which the WTO was ostensibly aimed at promoting.

With the collapse in Cancun, and little outside of procedural movements on cotton since, little has as-yet been delivered on the Initiative. Part of this can be attributed to the fact that whereas the push to eliminate cotton subsidies aligned closely with the tone of the broader Doha agricultural negotiations, the request for compensation was highly controversial. As such, despite initial objections by the proponents that seemed to have been worked out at a March 2004 WTO-convened donors meeting in Cotonou, the 2004 'July Package' (WTO 2004a), aimed at resuscitating the fledgling Doha talks, split the Initiative into two elements. This included those 'trade aspects' related to subsidy reduction, which would be "addressed ambitiously, expeditiously, and specifically, within the agriculture negotiations" – or in other words, not on a separate and expedited track as requested. However, as noted by Sumner (2005), by

¹³ Goreux's 2003 study estimated losses for WCA cotton producers, as opposed to the LDC net-exporters referred to in the WTO submission, however as outlined later by Goreux (2004a), with the degree of overlap between the two groups of countries and the similar production/export capacities of those excluded from each respective group, the cotton production and export between them differ by only 2%. As such, his study would still serve as a reasonable approximation of compensation required to address the injury caused by US and EU subsidies.

instructing that the matter receive “appropriate prioritisation” vis-à-vis other sectoral initiatives, this does not preclude specific provisions and/or commitments focussed on cotton within the broader agricultural deal (to which we return later).

On those aspects of the Initiative said to be related to ‘development assistance’, the WTO Director-General would consult with the development community so as to “direct effectively existing programmes and any additional resources towards development of the economies where cotton has vital importance.” Progress of work in all three pillars of market access, domestic support, and export competition, along with the coherence between the trade and development aspects would be the remit of a new sub-Committee on Cotton, formed under the auspices of the Special (negotiating) Session of the Committee on Agriculture.

Notwithstanding the fact that a request for monetary compensation as contained in the Initiative does not have precedence in the GATT/WTO system, the trajectory on which the July Framework places the outcome on cotton does not effectively address the underlying objectives of compensating for continued injury and serving as an additional incentive for reform. As we will discuss in more detail later, these two objectives cannot be met simply by the provision of additional funds – as proposed by ‘financial assistance’. Indeed, to be effective, transitional compensation must be explicitly tied to the reduction of distorting subsidies – without which there is the potential for compensation to drive greater aggregate cotton production, thereby depressing cotton prices even more and leading to further injury.

Only by making subsidy reduction and compensation complimentary actions can they serve as redress for continued injury and, at least in principle, as an additional incentive for reform. We note ‘in principle’ on the latter in that, as highlighted by Sumner (2005), the level of compensation requested (US\$ 250 million dollars) is dwarfed by the subsidies provided (upwards of US\$ 4 billion dollars) and the former could easily be included in the latter as an additional cost of facilitating acceptance of ‘business as usual’. As a complement to effective subsidy reduction commitments however, this does not diminish from the validity of, or more importantly the benefits derived from, having the major trading powers paying compensation to LDC net-exporters pending the reform of their distortionary ways.

Recognising the outstanding need to address these objectives, a more recent proposal (WTO 2005a) calls for, inter alia, an emergency support fund equivalent to 20 percent of the value of cotton production in the three most favourable recent years of each beneficiary. The resources contributed would decrease proportionately with the pace of removal of support and would be allocated directly to producers. The fund would be managed by a commission comprising donors, producers and governments. The timeframe initially envisaged would have seen this coming online by the end of 2005.

Like the initial attempts to include monetary compensation in the remit of the WTO however, the proposals for such an emergency fund have not been met with positive responses from the major trading powers and the matter of compensation remains at a standstill. While there appears to be scope for the subsidy reduction aspects to deliver on some degree of the much needed reform in the sector, it now being predicated on much more complex and sensitive across-the-board agricultural reforms implies a much slower timeline (along with the potential for ‘tradeoffs’ with other areas of the negotiations). Indeed, with the divergences on baseline agricultural reforms being so large, and Members now having accepted scaled-back results for Hong Kong, this view of little short-term progress on cotton reform arriving out of the broader negotiations is only reinforced. Recognising the likely slow progress of the negotiations, some observers were already pointing to the successful Brazilian challenge of US subsidies as an alternative avenue for pursuing more expeditious reforms in the sector. We turn now to consider the case and these claims.

3.2. Dispute Settlement – Brazil versus the US

Standing as one of the most important challenges to the agricultural policies of developed countries in the history of the WTO, the successful Brazilian challenge to elements of the US cotton support programme offers an additional avenue, albeit one somewhat limited in scope, to elicit significant reforms to trade in cotton in the short-term. In the medium-term it may address some of the more egregious distortions in the US programme (e.g. Step 2 payments and distortions stemming from export credit guarantees), however the extent and speed to which these and other reforms

emanating from the decision may occur is likely to be tempered by political economy considerations in Brazil over pushing the US to overcome entrenched domestic resistance. In addition, being focussed on US subsidies, the ruling does little to address EU distortions, which as discussed above, have also been shown to cause injury to competitive producers, especially those in WCA. These caveats notwithstanding however, the case does offer both a floor for the outcome of the forthcoming negotiations (both before and after Hong Kong), as well as a template for possible additional challenges to US and EU subsidies from competitive producing countries such as WCA, India, Pakistan and Australia.

With this in mind, we review below ‘*United States – Subsidies on Upland Cotton*’ (hereafter ‘the case’) as well as the findings of the Dispute Settlement Body Panel (hereafter ‘the Panel’; WTO (2005b)) and the subsequent Appellate Body (AB; WTO (2005c)) upholding of its decisions. We highlight specific areas of relevance for addressing distortions via the negotiations and limitations thereof.

In the shadows of the 2002 Farm Bill¹⁴, which authorised an additional US\$ 51 billion in support to US farmers over 2002-2007 (Becker 2002), Brazil requested consultations with the US regarding its cotton support programme in September 2002. In it (WTO 2002), Brazil alleged that various elements of US farm legislation constituted prohibited¹⁵ and actionable subsidies¹⁶ in violation of WTO rules on agriculture and subsidies (i.e. the Agreement on Agriculture (AoA), GATT 1994, and the Agreement on Subsidies and Countervailing Measures (ASCM)). Brazil held that these subsidies caused (for marketing year (MY) 1999-2001) and/or threatened to cause (for MY 2002-2007) adverse effects, in the sense of ‘serious prejudice’¹⁷, to their interests.

¹⁴ Adopted in May 2002, the 2002 Farm Bill is officially known as the ‘Farm Security and Rural Investment Act of 2002’.

¹⁵ Prohibited subsidies are those that require recipients to meet certain export targets, or to use domestic goods instead of imported goods.

¹⁶ Subsidies (allowed or otherwise) are deemed ‘actionable’ in the sense that they are countervailable if they confer a benefit to a specific enterprise or industry (de jure or de facto specificity), such that they cause (or threaten to cause) material injury to domestic industry.

¹⁷ Serious prejudice is said to occur (based on ASCM Article 6(c)) where the effect of a subsidy is to displace imports or exports, significantly depress or suppress prices in the same market, or increase the world market share of the subsidising Member (WTO 1995).

Based on the extensive evidence provided by the two main parties (as well as the numerous third parties¹⁸) in the case, the Panel ruled¹⁹ on two key issues: whether the subsidies provided were allowed or prohibited and, irrespective, whether they caused²⁰ ‘serious prejudice’ to Brazilian interests (Josling 2005). With the US being both the largest exporter and the largest absolute subsidiser of cotton, both questions clearly have important implications for the objective of reforming global cotton trade (even if the responses are restricted to the US context).

Listing the seven programmes of US support to cotton included in Brazil’s challenge, ordered from most to least distortionary as per Sumner (2003)²¹, Table 4 below highlights the key elements of the ruling.

On the issue of whether subsidies were allowed or prohibited, the Panel found that the user marketing payments – or Step 2 payments²², were contingent on export performance and thus prohibited under the ASCM. Payments to exporters were found to constitute prohibited export subsidies not included in the US’ Schedule of subsidies²³, while those to mills using US cotton were deemed prohibited import substitution subsidies. For this, the Panel instructed the US to remove the prohibited subsidies “without delay” and not later than 1 July 2005.

In addition, with the Step 2 payments being contingent on cotton prices, the Panel found that they were causally related to depressed and suppressed world cotton prices, and thus in part responsible for serious prejudice to Brazilian interests. Similarly, by maintaining higher US cotton production (and export) levels in the face of lower

¹⁸ Third parties to the case included Argentina, Australia, Benin, Canada, Chad, China, Chinese Taipei, European Union, India, New Zealand, Pakistan, Paraguay, and Venezuela.

¹⁹ Due to the AB report upholding the key finding of the Panel, unless otherwise specified, ‘ruling’ shall refer to both the DSB and AB ruling.

²⁰ On the claim of ‘threat’ of serious prejudice for a basket of subsidies to be granted in the future, the Panel found it unnecessary to rule. They did so in light of the potential for the significant transformation of future support measures resulting from the withdrawal of relevant subsidies (either prohibited and/or causing present serious prejudice) prescribed in their ruling (as to be seen below).

²¹ See Table 1; this excludes cottonseed payments (number 7), which were not included in his analysis but did form a part of the case.

²² Step 2 payments are provided to domestic users of US cotton and/or exporters to cover the difference in cost between (higher) US cotton prices and (lower) world prices.

²³ The US’ Schedule of commitments on domestic support and export subsidies on agricultural products can be found in Schedule XX of the United States of America, Part IV, Section II entitled “Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments” in their GATT Schedule of Commitments.

world prices (effectively shielding US cotton farmers from world price trends), the other two price-contingent programmes – the marketing loan payments²⁴ and the market loss assistance/counter cyclical payments²⁵ – were also found to be responsible for depressing and suppressing global cotton prices and thus causing serious prejudice. For this group of programmes, the US was to remove the adverse effects (causing serious prejudice) or withdraw the subsidies – which based on ASCM Article 7.9, is to occur “within six months from the date when the DSB adopts the panel report or the Appellate Body report” (WTO 1995). With the latter having occurred 21 March 2005, this implied a 21 September 2005 deadline.

Of note however, the Panel did not feel it was necessary to quantify the degree to which expenditures in these price-contingent programmes needed to be reduced or changed to comply with the adverse effects ruling. In doing so, it opened a degree of ambiguity over exactly what is required for compliance with this finding, and as such, to what degree such compliance might contribute to the broader objectives of meaningful reform of the (US) cotton sector.

For the three programmes not contingent on cotton prices, but rather aimed at income support, the Panel did not find causal evidence of price depression and suppression. These include crop insurance subsidies and cottonseed payments, despite the former being found by Sumner (2003) to cause downward pressure on global prices similar in magnitude to the market loss assistance/counter cyclical payments programme (see Table 1).

The third non price-contingent programme, the production flexibility contract (PFC) payments (which were in use from 1996 to mid-2002) and the subsequent direct

²⁴ The marketing loan programme (comprising marketing loan gains, loan deficiency payments and commodity certificate exchange gains) is intended to minimise potential loan forfeitures by providing interim financing to eligible producers on their eligible production and facilitate the orderly distribution of eligible commodities throughout the year. Rather than selling the crop at harvest when prices tend to be at their lowest, the proceeds of the interim loan enable producers to pay off their expenses when they become due, while storing their pledged harvested crop as collateral and repaying the loan when market conditions are potentially more favourable.

²⁵ Market loss assistance (MLA) payments were annual ad hoc emergency measures from 1998-2001, aimed at making up losses sustained to producers’ income as a result of recently low commodity prices. These were formalised in the 2002 Farm Bill as the counter-cyclical payments (CPP) programme, which filled a gap in revenues whenever ‘effective’ domestic cotton prices fell below a target rate of \$0.72/pound (effective domestic prices include direct payments and, where applicable, loan gains) (WTO 2005b)

payments (DP) (brought in by the 2002 Farm Bill to cover until September 2007) were not deemed prohibited subsidies either, however they were found to have been erroneously notified by the US as ‘green box’²⁶ measures. While not being strictly based on production targets, the Panel ruled that in keeping eligibility for the programmes related to certain types of agricultural production (i.e. by maintaining restrictions on current land usage), they were insufficiently de-coupled from production and thus should rather have been notified as ‘amber box’²⁷ measures. Importantly, as we shall discuss below with respect to the Peace Clause, by ruling in this manner, the US was deemed to put itself in violation of subsidy disciplines in the AoA, thus exposing its entire domestic support regime to challenge under the SCM for causing adverse effects.

On export credit guarantees,²⁸ the Panel ruled that due to the premiums not covering the long-term net operating costs of the programmes, they constituted export subsidies as defined in the ASCM’s Illustrative List of Export Subsidies (Annex I, item (j)). Furthermore, the ruling (upheld by a majority decision by the AB) found that the subsidies were not exempt from export subsidy disciplines in the AoA. For those products not included in the US’ Schedule of subsidies – for which cotton is not²⁹ – they constituted prohibited export subsidies. It was also found that for rice, which is included in the Schedule, the US had exceeded its commitment. These prohibited subsidies were also to be removed “without delay” and not later than July 2005.

²⁶ Green box (domestic) subsidies, as defined in Annex 2 of the AoA, must have no, or at most minimal, trade-distorting effects. They often include government services, as well as direct payments made to farmers that do not stimulate production (i.e. they must be ‘de-coupled’ from production). Importantly, they do not currently have expenditure limits, nor are they subject to reduction commitments.

²⁷ Amber box subsidies include all domestic support measures not eligible for the blue (production-limiting) and green (see note 26) boxes, such as measures to support prices, or subsidies directly related to production quantities. They are subject to limitations (a ‘de minimus’ level of support up to 5% of agricultural production for developed countries; 10% for developing countries), as well as reduction commitments (based on an ‘aggregate measure of support’ or AMS figure).

²⁸ Three such programmes run by the US government’s ‘Commodity Credit Corporation’ were considered by the Panel: GSM 102, which guarantees the repayment of credit made available to finance commercial export sales of agricultural commodities on credit terms that do not exceed three years ; GSM 103, which guarantees the repayment of credit made available by financial institutions in the US to finance commercial export sales of agricultural commodities on credit terms of between 3 and 10 years; and SCGP, which issues guarantees for the repayment of credit made available for a period of not more than 180 days by a US exporter to a buyer in another country (WTO 2005b).

²⁹ Other products not included in the Schedule include corn, oilseed, oil products and soybeans.

The implications of the ruling are far-reaching. Two legal implications have been highlighted (Josling 2005; Halverson Cross 2005), relating to the Peace Clause and the determination of serious prejudice. The Peace Clause (AoA Article 13), which expired at the end of 2003, protected certain developed country agricultural support measures to challenges under WTO rules on subsidies. Measures protected included permitted export subsidies, ‘green box’ subsidies, and domestic support measures below MY 1992 levels. While the case did not challenge the Peace Clause per se (ruling, as indicated earlier, that the US had effectively disqualified itself from Peace Clause protection by erroneously classifying green box support and surpassing its 1992 levels), it did offer an indication on how to apply the ASCM to agriculture (Halverson Cross 2005). In particular, it did so with respect to the ability to challenge domestic support measures under the ASCM irrespective of whether they are deemed allowable by the AoA.³⁰ By extension, this would more easily expose such domestic support to claims of serious prejudice. Indeed, due in part to the difficulties in demonstrating serious prejudice, this case is only the second to successfully do so with respect to domestic support measures³¹ (Halverson Cross 2005). The way in which it occurred in this case also speaks to the importance of econometric work such as that reviewed earlier in supporting Members’ ability to show the causal impacts of domestic policies.

For the purposes of the negotiations aimed at addressing global distortions in cotton trade, the case also carries important significance. The ruling itself clearly has the potential to elicit a great deal of the same objectives as those sought in the Cotton Initiative. As alluded to by Goreux (2004a), US compliance, by removing the prohibited export subsidies and withdrawing or removing the adverse effects of those found to cause serious prejudice, would (based on Sumner’s estimates) achieve just over 9 percent of the 11.6 percent gain in cotton prices stemming from subsidy removal over the 1999-2001 period. In addition, the ruling on alleged green box measures and the clarification of criteria for eligibility could prove valuable in a discussion over mechanisms to ensure the reduction or elimination of trade-distorting cotton subsidies does not occur simply by re-classifying them under the green box –

³⁰ See Steinberg and Josling (2003) for an in-depth legal discussion on the vulnerability of US and EU agricultural subsidies in light of the Peace Clause expiry.

³¹ The other was *Indonesia – Autos*; WT/DS54, WT/DS55, WT/DS59, WT/DS64.

which currently has a fairly open definition and does not have an expenditure limit (see section 4.1).

Despite a deadline of 1 July 2005 for the elimination of prohibited subsidies and the instruction to remove the adverse effects (causing serious prejudice) or withdraw the relevant actionable subsidies as of 21 September 2005, little by way of compliance has as-yet occurred. On 30 June, the US Department of Agriculture (USDA) announced the elimination of the 1 percent cap on fees in the remaining export credit guarantee programmes (GSM-102 and SCGP)³², thus addressing the Panel's concern that the schemes' fees were insufficiently risk-based. Legislation was also sent on 5 July to the US Congress recommending the repeal of the Step 2 payments, however they were not scheduled therein to be removed before 31 July 2006.

Concerned with the compliance on prohibited subsidies coming more than a year after the deadline, and wanting to safeguard its rights to retaliate under the AGSM and the DSU, on 5 July Brazil requested authorisation to impose \$US 3 billion in retaliation for failure to repeal the measures in the allotted time. This included requests for the suspension of tariff concessions under the GATT 1994, as well as cross-retaliation in the form of suspended concession in TRIPs and GATS. At the same time however, recognising the amendment to the export credit programme and the proposed repeal of the Step 2 programme, the two Members came to an understanding such that the retaliation authorisation request would be suspended, which due to the US' challenge of the level and appropriateness of Brazil's request, was to be sent to arbitration. These arbitration proceedings have thus been suspended pending a compliance panel ruling on whether the measures taken by the US constituted compliance (highlighting again the difficulties posed by the Panel's lack of specifying the degree of expenditure amendment required).

On the actionable subsidies causing serious prejudice, for which the adverse effects were to be removed or the subsidies withdrawn by 21 September 2005, a similar procedural agreement has been reached. On 5 October, the Chair of the US Senate Agriculture Committee intimated that the relevant programmes deemed to have

³² The GSM-103 programme was also eliminated however this programme had not been used for cotton in the past and had only been used marginally for other commodities.

caused serious prejudice were unlikely to be altered prior to the following Farm Bill, which would only come into effect in September 2007. The following day, Brazil filed a request for authorisation to apply US\$ 1.037 billion in suspended concessions³³ in goods (including additional import tariffs), intellectual property rights (TRIPs), and services (GATS). With the US contesting that the countermeasures are commensurate with the degree and nature of the adverse effects determined to exist, the matter was remanded to arbitration on 18 October. As above, the two Members have recently agreed to suspend the arbitration proceeding pending the outcome of a compliance panel ruling.

From the state-of-play outlined above, it is clear that Brazil is making use of all legal remedies available to leverage the US to move forward with compliance, especially via its requests for cross-retaliation via TRIPs and GATS.³⁴ Observers however have noted that Brazil is unlikely to actually proceed with the cross-retaliation (should it be authorised)³⁵ out of concerns of inciting a trade war with the US. Touching on exactly those concerns, former US Trade Representative Robert Zoellick indicated soon after the latest retaliation request that Brazil's GSP benefits (amounting to over US\$ 2.5 billion) could be jeopardised should it decide to proceed down the road of retaliation.

Consequently, while the case would seem poised to make some impact on the distortionary effects of export credit guarantee and Step 2 programmes in the medium-term (assuming these changes remove all distortionary effects, amounting to a 4 percent increase in world prices), meaningful progress on the other programmes causing serious prejudice seem likely to come from a longer-term negotiating process. This includes one between the US and Brazil directly and the US and the larger WTO membership more broadly in the context of the agricultural negotiations. Reiterating our point made earlier, this recognition only reinforces the support for implementing a

³³ This amount corresponds to the annual average value of US surplus production resulting from subsidisation from 1999-2002 (as estimated by Sumner 2003) multiplied by international prices for that period.

³⁴ Cross-retaliation has been authorised once before in the WTO, as part of the 1999 banana dispute between Ecuador and the EU. With the two Members having arrived at a negotiated agreement however, Ecuador opted not to exercise its cross-retaliatory rights.

³⁵ See Basso and Beas (2005) for an overview on the potential difficulties in utilising TRIPs as an instrument of retaliation.

transitional compensation mechanism in the meantime – which is not, as we shall delve into further now – equivalent to the proposals for financial assistance.

3.3. Financial assistance

The second track under which efforts are ostensibly being undertaken to address distortions in global cotton trade occur outside the purview of the WTO. While having been equated – wrongly in our view – with the compensation proposal contained in the Cotton Initiative, the ‘development assistance aspects’ of this track have largely been a discussion between African cotton producers and the development/donor community. Recent discussions confirm the focus on providing investment resources for the longer-term objectives of promoting greater competitiveness (economy-wide and in the cotton sector), as well as export diversification more broadly. While few observers of the challenges facing cotton-dependent developing countries would dispute the importance of such resources in helping them promote growth and reduce poverty, there is a misconception that this can serve as a substitute for the short-term aim of compensation. Of perhaps greater importance, the prospect of financial assistance in lieu of meaningful reform to US and EU cotton support programmes carries dangerous implications for the trading system as a whole.

As touched on earlier, the proponents of the Cotton Initiative were initially reticent to divide it into separate tracks. Their acquiescence was obtained however in the lead-up to the 23-24 March 2005 WTO African Regional Workshop on Cotton, which brought together the 33 African countries engaged in cotton production and trade and the major national and intergovernmental donors. The result was the present situation – with the subsidy-reduction elements of the Initiative subsumed in the much larger and more complex agricultural negotiations and the compensation-cum-financing elements carved out of the WTO’s remit and put into the hands of the donor community.

It is noteworthy to highlight the contradiction here that the problems for which this event was purportedly attempting to address stemmed from subsidy-induced

distortions in cotton *trade*, however subsidy reduction and recompense pending its arrival were explicitly kept off the agenda. As noted by Oxfam (2004b), the programme for the conference had an exclusive focus on “the Development Aspects, particularly the scope and opportunities for financial and technical assistance”, and was aimed at contributing to, inter alia, “a more focussed understanding of some of the policy issues underpinning the [Initiative]...” (WTO 2004b, p. 22). Surely financial and technical assistance are part of the needed solution, but avoiding discussions on the very source of the problem – the persistence of cotton subsidies, and the adjustment mechanism requested by those most injured seems at odds with what should otherwise be the core objective of these efforts.

The current state of these efforts, while facilitating a wealth of discussions, conferences and project planning have produced little in terms of short-term respite from the injury resulting from distorted cotton trade. Emanating from the Cotonou meeting, the IFIs (World Bank and IMF) and other multilateral agencies (including FAO, ITC, OECD, and UNIDO) have aimed at focussing existing instruments on cotton-related challenges. This includes the Bank’s PRSP papers, the IMF’s PRGF lending facility, and numerous technical assistance and capacity building projects aimed at enhancing competitiveness and value-added production in the cotton sector. Especially highlighted has been the Diagnostic Trade Integration Studies undertaken under the auspices of the multi-agency Integrated Framework.

With respect to bilateral donors, both the pledges and associated actions have been similarly focussed. Calls have been made to reflect ‘cotton-sector priorities’ in their country programmes and provide financial and technical assistance for relevant projects. As above, there is also much talk of ‘enhanced coordination’ and ‘follow up workshops’ to ensure these laudable endeavours are proceeding as intended.

In this respect, the EU and US programmes are notable, both for the pittance of resources allocated (relative to the amount of subsidies provided) and the lack of concomitant commitments to address the core of the problem – the sustained injury resulting from continued subsidisation of high-cost cotton producers.

The ‘EU-Africa Cotton Partnership’³⁶, launched at a July 2004 forum in Paris, outlines an action plan focussed on seven areas.³⁷ While the area on international trade does call for an effective and specific solution amenable to all parties, it maintains that these are best held in the context of the broader agriculture negotiations. Unfortunately, in terms of commitments, there is little more than the April 2004 announcement that 65 percent of EU support to cotton would be decoupled from production. Leaving a full 35 percent still tied to production, alongside the as-yet unknown impact of the announced reforms that are only to come into effect in 2006, the degree to which this will alleviate the injury being caused by EU subsidies remains to be seen.³⁸ On technical assistance and capacity building, €40 million is to be allocated to the Initiative proponents’ national programmes, with an additional €15 million for ACP-wide cotton-related activities. This €55 million (in the range of US\$ 65-70 million) pales however in comparison to the US\$ 800+ million in subsidies provided in 2001/02 alone (see section 2.2 above).

Within the context of their efforts to assist cotton producers, the EU has also highlighted changes in access criteria of the Cotonou Agreement-related FLEX instrument³⁹ as a potential financing mechanism to mitigate the effects of export earning shortfalls. It would seem somewhat contradictory however that the EU would be willing to consider making compensation funds available for earning shortfalls that result, in part, due to the EU’s very own domestic cotton support policies and at the same time oppose the Initiative’s request for a similar type of mechanism (see sections 3.1 and 4.2).

Like the EU, the US points to various existing aid-related endeavours as examples of efforts being undertaken to support African cotton producers (for example the G8 debt

³⁶ See the EU ‘Proposal for an EU-Africa partnership in support of cotton sector development’ at <http://www.cotton-forum.org/docs/parteneriat-en.pdf> and the summary of proceedings of the July meeting at http://www.cta.nl/pubs/coton/Cotton_Forum.pdf.

³⁷ This includes i) international trade; ii) national and regional cotton strategies; iii) policies and institutions; iv) technological innovation; v) risk management; vi) chain integration; and vii) coordination.

³⁸ Goreux (2004a) notes that the changes implied by the proposed EU reforms (and the remaining coupled subsidies) would not necessarily alter the level of cotton production in Greece.

³⁹ The FLEX instrument (Fluctuations in Export Earnings) was introduced in 2000 in the framework of EU ACP co-operation to assist governments facing sudden losses of export revenues. Due however to restrictive eligibility criteria, from 2000-02, only € 35.65 million had been distributed as part of six successful applications (out of 51). Had the new criteria been in place originally, the applications submitted would have resulted in a € 255 disbursement.

relief announcement and the Millennium Challenge Co-operation). The US has also announced very recently the ‘West Africa Cotton Improvement Program’⁴⁰, for which they have committed an initial US\$ 5 million in new funding (\$7 million in total) aimed at improving the production, transformation and marketing of cotton in the four WCA proponent countries (plus Senegal).⁴¹ Not only however, are the resources dwarfed by the billions of dollars in annual US cotton subsidies, the programme does little by way of addressing the injury that continued US subsidies will inflict on these WCA countries, along with the other developing countries (such as Brazil, India and Pakistan) who stand to gain nothing from these endeavours.

With these and other inadequate proposals, it is not surprising that the response from the WCA proponents, along with other African cotton producers, has generally been one of disappointment. While welcoming much needed aid activities, the fact remains that these activities do little to facilitate these cotton producers from taking advantage of their competitive edge in cotton, nor in compensating them for continued loss of market share and export earnings (estimated at US\$ 250 million annually) while US and EU producers continue to receive extremely generous governmental support. The proponents have thus appealed to those subsidising countries for stepped up efforts, commensurate with the scale of challenges being faced. As well, with so much focus on WCA, and in particular the four proponents of the Cotton Initiative, other African producers have called for a broader continental focus of activities.

The discussion above is not meant to imply however that there is no role for financial assistance. Indeed with scarce investment resources contributing to an ‘international poverty trap’ in much of SSA (UNCTAD 2002), additional financial assistance to cotton-dependent developing countries is a necessary condition for their growth and poverty reduction prospects. This includes much needed resources to facilitate economy-wide productivity-enhancing investments, such as the building of roads, ports, and broader institutional infrastructures (e.g. customs administration), as well as investments focussed specifically at the cotton sector, such as relevant local R&D to

⁴⁰ See 10 November 2005, USDA News Release No. 0486.05, <http://www.usda.gov>.

⁴¹ The programme will focus on: i) promoting the use of good agricultural practices; ii) strengthening private agricultural organisations; iii) providing training for West African ginners; iv) improving the quality of WCA cotton via better classification; v) improving linkages with relevant US research organisations; vi) improving the enabling environment for biotechnology; and vii) policy/institutional reform.

boost labour and land productivity in smallholder farms and support improved marketing and distribution know-how. In addition, to promote structural transformation and export diversification in the economy, a vast range of skills will have to be developed to facilitate more value-added processing of cotton-based products (including, but not exclusive to, the production of textiles and garments).

The fact remains however that none of the above addresses the continued injury caused by the billions of dollars in subsidies that undermine competitive cotton producers in Africa and elsewhere in the world. Indeed in this sense, there is a clear and present danger that financial assistance could be targeted expressly at alleviating the pressures on the US and EU to do just that – confront their powerful domestic cotton interests and move ahead with reforms to their cotton support programmes. Two concerns rise to the fore should financial assistance be used to undermine the pressures for reform in the EU and US cotton sector.

The first is systemic and relates to the legitimacy of the multilateral trading system (MTS) and its capacity to protect the interests of its most vulnerable Members. With such a clear imbalance in global cotton trade, attempts by the major trading powers to use financial assistance to effectively buy their way out of having to make difficult reforms at home sends a powerful and dangerous signal regarding their commitment to trade liberalisation and rules-based economic governance regimes more broadly. The loss in legitimacy to the MTS that such signals would engender would be detrimental to all countries involved. It would also likely spell, at the very least, a hiatus for the Doha negotiations.

Secondly, there is the risk that financial assistance in the absence of reform in the US and EU could worsen the situation brought on by subsidy-induced overproduction in cotton by further depressing global prices and lowering export earnings. As noted earlier with respect to compensation without subsidy reform, were the assistance to be transmitted (even partially) to already competitive producers in such a way as to replicate the market conditions that would have existed without US and EU subsidies then, *ceteris paribus*, cotton production and exports from these countries would increase. In the absence of subsidy removal in the US and EU and thus no change in their production levels, the global supply of cotton would then also increase.

Depending on the magnitude of the supply response in the recipient countries (determined by their supply elasticities), this could further depress global cotton prices and result in lower per unit revenue both on the original output and the assistance-induced output. While the net effect would be contingent on the size of the supply response and the impact on global prices, the potential for further injury is plausible.

Additional concerns related to financial assistance include the diversion of international aid resources from other development priorities, the question of whether this would be a judicious use of taxpayer money, and the potential, if such assistance were loan-based, to further aggravate the as-yet unresolved debt problems facing most developing country cotton producers (Oxfam 2004a). It would also reinforce the perception of developing countries being dependent on handouts from rich countries, as opposed to promoting the fact (especially in the cotton context) that they are capable to generate (at least some portion of) the additional investment resources required, were a more level playing field available to them.

Put simply, financial assistance is not a substitute for compensation, but rather a compliment – both to compensation and the broader subsidy reduction agenda. While it could surely be of benefit (as part of such a broader reform agenda) were adequate resources dedicated, current efforts indicate this is not to be the case. On its own however, financial assistance cannot address the structural problem at hand, the persistence of distorted cotton trade as a result of continued subsidisation to US and EU cotton producers. Furthermore, financial assistance focussed on the WCA countries, or even SSA more broadly, offers little for cotton producing countries of the likes of Brazil, India, and Pakistan, etc – who stand to gain far larger benefits (in absolute terms) from global cotton reform.

What the discussion above highlights is that the current agenda to reform global cotton trade is both inadequate in ambition and unlikely to result in meaningful outcomes in the short- or possibly even medium-term. For this reason, we turn now to consider areas for possible improvement, both within the existing activities discussed above and beyond.

4. What's not being done?

Having reviewed above initiatives currently on the agenda to promote the reform of global cotton trade, we discuss here potential improvements that might be considered vis-à-vis subsidy reduction, compensation, financial assistance, and dispute settlement litigation. We also touch briefly on some systemic commodity issues requiring attention if developing country cotton producers are to have the opportunity to maximise the benefits of their competitive advantage.

While it would appear that meaningful subsidy reduction will not occur in the short-term, it is of the utmost importance that when it does, adequate proposals have been put forward to ensure the process does not become one of simply shifting payments to the uncapped and loosely-defined green box. In addition, in light of the slow pace at which deep reforms to the cotton sector are likely to occur – predicated as they are on the overall agricultural negotiations – we underscore the importance of putting some type of compensation mechanism back on the trade agenda (irrespective of whether it is delivered via a WTO mechanism). If insufficient reforms seem imminent, even in the medium term, then it will be up to those Members aggrieved to consider the merits of proceeding to dispute settlement.

Outside the WTO, the resources being allocated for financial assistance must be greatly enhanced if they are to effectively fill the chronic savings/investment gap that exists in most Africa cotton producing countries. In addition, if the global community is serious about helping create an environment conducive to competitive developing country cotton producers trading their way out of poverty, certain issues endemic to primary commodities (and its dependence) will also have to be addressed. This includes addressing the long-run secular decline and volatility in cotton prices, as well as the barriers to market access and market entry for cotton and higher value-added cotton products. Other areas include low productivity in the cotton sector and poor access to technology and finance to facilitate increased competitiveness and export diversification.

4.1. Subsidy reduction

While likely implying a much slower delivery of cotton reforms, the fact remains that the subsidy reduction component of the Cotton Initiative is now subsumed in the broader agriculture negotiations and this is unlikely to be reversed. While not necessarily precluding an accelerated track for cotton, there is a need for improvements in the current discussions – both in substance and timeline – if Members are to live up to the Doha Development Agenda and in particular the July Framework mandate of addressing cotton “ambitiously, expeditiously, and specifically [...]” (WTO 2004a).

Recognising the political difficulties facing the immediate elimination of all cotton support measures in the US and EU, a consideration of other avenues to address the distortions resulting from these measures is likely the most appropriate initial approach. In this sense, Baffes (2004) notes the increased popularity of de-coupled support measures (i.e. payments not tied to the level of production). However, for such measures to have the beneficial impacts intended, he highlights three essential conditions: i) replacing 100 percent of support mechanisms with de-coupled support; ii) ensuring the de-coupled support is explicitly time-limited so as to be an effective transitory mechanism towards elimination; and iii) ensuring eligibility for de-coupled support is not predicated on the obligation to keep resources in agriculture (thus facilitating a reduction in supply and an increase in world prices).

Indeed the EU’s proposed cotton reforms, as touched on earlier, are an example of attempts to move in this direction. However, with less than full transition to de-coupled measures and thus 35 percent of their support to remain tied to the amount of area in cotton production, the degree to which these reforms will deliver the professed benefits remains to be seen (ibid). Equally, for the US, with the Panel decision finding that de-coupled payments (PFC/DP) notified as green box measure were ineligible for such classification, domestic legislators have recently alluded to the need to ‘tighten up’ up such programmes to ensure they are eligible in the future.

Consequently, with the key subsidising Members increasingly looking to the decoupling of their existing support as a mechanism to remove the distortionary effects (and thus in their view undertake ‘reforms’), a key area for improvement on substance is the need to develop specific proposals to ensure that support measures moved from the amber to green box are in fact minimally trade-distorting. Without such a mechanism, the currently uncapped – and in the view of many developing country Members, ill-defined – green box offers too much leeway for subsidising Members to obviate from real reforms to the sector.⁴²

While a detailed discussion of such mechanisms lies beyond the scope of the current paper, one could envisage proposals such as cotton-specific reduction commitments based on the amount and classification of support measures as notified in the base period (i.e. committing to reductions *before* support measures can be re-classified under the green box). In addition, in line with Baffes’ criteria above, introducing some concept of time limitation for such measures could be an effective way of garnering greater support amongst developing countries for box-shifting in the initial stages, thereby offering more breathing room for subsidising Members to make the needed reforms at home. Finally, while agreement-wide calls for expenditure caps and more specific criteria for the green box have been strongly rejected by many developed country Members, there may be a more receptive climate for such disciplines focussed specifically on cotton. Indeed, at least with respect to restricting current land usage for payment eligibility, the Panel ruling offers some clarification to existing green box guidelines, acting in effect as a floor for any future discussions in this area. Both the panel ruling and the concerns highlighted here also highlight the importance of ensuring that the review of green box criteria, as mandated in the July Framework, is as comprehensive as possible, as well as that cotton-specific requirements are embedded in the envisaged amendments to future subsidy notifications and monitoring thereof.

Another area of substance requiring urgent attention is the use of the base year for reduction commitments. As it stands, Members are considering either of 1995-2000 or 1999-2001 as the base year for agricultural support expenditures, upon which

⁴² Indeed, without a cap on green box spending, it is altogether conceivable that support to inefficient cotton producers could increase in the future.

reduction commitments will be made. For either of these periods however (especially the latter) governmental expenditures to support cotton were extremely high in both the US and EU, and as such, using them to base reduction commitments would greatly diminish the intended impact, if not rendering the exercise useless altogether. In this regard, cotton producing developing countries may want to propose a more appropriate timeframe for the base year for cotton-specific reductions, either one with a longer timeframe to dampen the influence of higher subsidy expenditures in the last decade, or an earlier time frame that better reflects historical expenditures prior to the recent increase.

With respect to the timeline of reforms, a fixed date must clearly be agreed upon for the elimination of all forms of export subsidies and trade-distorting domestic support to the cotton sector. At the same time however, the difficulty of obtaining definitive dates for this, without the foundation of similar dates being made in the overall negotiations, also needs to be acknowledged. A middle ground that could be considered (predicated on an effective compensation mechanism) would include an early harvest, followed by a structure on agreed reductions over time, contingent on the overall starting date (to be determined later). Indeed, with respect to trade-distorting domestic support, a similar approach has recently been put forward.⁴³

On export subsidies, in line with the US' stated intentions to comply with elements of the Brazilian challenge, these could conceivably be eliminated by mid-2006 (after the following marketing year in the US, where farmers have already planned production assuming such support).⁴⁴ On trade-distorting domestic support (i.e. amber box measures), assuming the reduction commitments made as part of the Doha round are to start in year x (which in all likelihood will not come prior to the next US Presidential election scheduled for late 2008), one could envisage in year x a 40 percent reduction of domestic support. At double the 20 percent reduction already agreed to in the July Framework, such a figure is intended to ensure actual cuts are made immediately upon implementation (as opposed to theoretical cuts), while acknowledging the political difficulty of exacting deeper cuts (especially from the

⁴³ A recent proposal from the WCA proponents envisages an 80 percent cut upon implementation, with an additional 10 percent cut in each of the following two years (more on this and the other latest proposals in section 5).

⁴⁴ The EU does not have export subsidies for cotton.

US) at this point in time. These could be followed by an additional 20 percent reduction in year $x+1$ and 15 percent in year $x+2$. Add to this an early harvest reduction in domestic support of 25 percent upon agreement (but to be implemented in mid-2006), and all cotton export subsidies and over half of trade-distorting domestic support measures would be eliminated by 2009. While the early harvest reduction in particular would pose some difficulties for the US administration, offers for domestic compensation to facilitate acceptance of changes after the following marketing year – as proposed in discussions surrounding the US legislation for Step 2 removal – could help facilitate such a move. For its part, the EU has recently proposed to eliminate the most trade-distorting support for cotton immediately upon implementation of the round, and thus should exhibit little resistance to the structure above.

These suggestions however are predicated on the development of a compensation mechanism to offset the injury to be inflicted on the competitive net-exporting LDCs pending such reforms.

4.2. Compensation and financial assistance

Recognising the lengthy negotiations ahead before reforms to the US and EU cotton support programmes are achieved, the issue of temporary compensation (as distinct from financial assistance) would appear to be deserving of renewed consideration amongst WTO Members. In terms of financial assistance, commitments already made should be translated into concrete action plans, for which the resources allocated should be greatly augmented.

As discussed above, to be most effective, the delivery of compensation must be tied explicitly to the reduction of subsidies. This does not preclude however the creation of such a mechanism outside the auspices of the WTO, including on a contractually binding bilateral (as opposed to multilateral) level. The example highlighted earlier of the EU's FLEX mechanism to compensate developing countries for unstable export earnings offers an interesting avenue for further investigation.

As part of the FLEX mechanism, it is conceivable that the EU could create a sub-scheme wherein the funds allocated were proportionate to the injury caused to LDC net-exporting cotton producers from EU subsidies. Distribution to beneficiaries could be determined on the basis of net exports and delivered directly to producers by way of replicating the world cotton prices that would have otherwise existed were there no subsidy-induced distortions. A similar such 'emergency support fund' was in fact proposed in the African Group April 2005 submission (WTO 2005a), however set in a WTO-related, multilateral context. Created alternatively outside its auspices, the allocation and distribution of funds could be tied to the EU's WTO reduction commitments, thus maximising the effectiveness of the mechanism. Constructed as such, it could also temper some of the developed country concerns over setting a precedent for a WTO-sanctioned financial compensation mechanism.

A similar bilateral mechanism could be considered for the US, perhaps in exchange for the proponents accepting the delayed implementation of both the removal of prohibited export subsidies and the early harvest domestic support reduction until mid-2006 (with a time-limited 'Peace Clause'-type agreement not to bring these measures to the DSB in the meantime). Arranged as such, those cotton producers not scheduled to receive compensation would receive benefits by way of the agreed subsidy reduction (for which the US reforms would have a relatively larger impact). Indeed, according to the Gillson et al. research reviewed earlier, the likes of Australia, Brazil, India and Pakistan would stand to gain much more by such an arrangement.

While possible mechanisms are not limited to those proposed and/or outlined above (this is clearly an area deserving of further research), it would seem appropriate that the aggregate amount of compensation be in the US\$ 150-300 million per annum range for it to effectively redress the injury caused to net-exporting LDCs by continued subsidies. To act as an effective additional incentive for reform, the amount would have to be at least 3-4 times that amount, which in light of its unlikely occurrence, implies the compensation mechanism is perhaps best directed at addressing continued injury.

Similarly, if financial assistance of is to be a truly effective tool for promoting the competitiveness of cotton producers and the pursuit of export diversification in those

nations, the resources allocated would need to be greatly enhanced. To help appreciate the magnitude of funding required, a 2001 UNECA study estimated an investment rate of 40 percent of GDP to facilitate diversifying into higher value-added products. For the four proponent WCA countries alone, this would amount to approximately US\$ 1-1.5 billion *each* per annum. Furthermore, as underscored by Oxfam (2004b), it is essential that such assistance not be conditioned on reducing pressure in the WTO for subsidy reform, nor should it exacerbate the beneficiaries' debt position. In addition, the development of programme activities should be inclusive of all stakeholders.

A final caution regarding both compensation and the financial assistance is the importance to ensure that the funds allocated to either are in addition to those already earmarked for aid-related activities. Without such assurances, there would be a danger of diverting existing funds to the detriment of other important initiatives.

4.3. Dispute Settlement

With respect to litigation via the WTO's DSB, two areas for potential improvements exist. The first relates to the initial ruling in favour of Brazil against the US, while the second addresses the potential for additional cotton-related disputes (focussed on either or both the US and EU). On the former, we touch briefly on some recommendations made in Sumner (2005) that might mitigate the serious prejudice caused by the US' trade-distorting support measures. For the latter, should the negotiations prove unable to deliver on meaningful reform in a timely fashion, we discuss some considerations to be accounted for should the proponents want to consider a DSB case.

On the Brazil-US case, Sumner (2005) has made some useful suggestions that could contribute in the near-term to mitigating the adverse effects caused by US amber box support measures. Specifically, he focuses on those measures shown (in his 2003 analysis) to be most distortionary in the 2004-07 period – namely the marketing loan assistance and counter-cyclical payments. On the former, he suggests lowering the loan rate and changing the formula so as to raise the effective loan repayment rate

(and thus tighten the degree of subsidy paid to farmers). For counter-cyclical payments, he suggests reducing the target price to lower overall expenditures and removing restrictions on the types of production allowed on land previously used for cotton, so as to more effectively de-couple the payments and minimise their distortionary effects. He also emphasises the importance of eliminating the Step 2 payments, which as highlighted above, are now scheduled for removal in mid-2006.

As noted earlier however, the lack of specificity as to the extent to which these subsidies must be reduced or removed maintains a degree of uncertainty over what is actually required of the US for compliance. In this respect, the forthcoming compliance panel (see section 3.3) could contribute to the push for deeper and more expeditious reforms by clarifying this particular aspect of the ruling.

On dispute settlement options for other cotton producers, such as the WCA proponents of the Initiative, the lack of timely movement in the negotiations could prove a sufficient incentive to proceed with litigation. Two commonly offered reasons why this is unlikely to occur include the high costs associated with bringing a case to the WTO's DSB and the systemic shortcomings of the remedies at their disposal. While funding could likely be obtained to support such a case, the latter concern is one held by many developing countries, who view the remedies available in the DSU putting them at a systemic disadvantage.⁴⁵

Specifically, in the context of our discussion here, the remedies are usually limited to the suspension of tariff concessions against the offending Member. By imposing additional duties, this would effectively raise the costs of imports, which for a small developing country, who may be highly dependent on the other Member for consumer and producer imports, would carry negative socio-economic impacts. It is in part for this reason that, as discussed above, Brazil has requested cross-retaliation in the form of suspending concessions on intellectual property rights and services. Again however, for small developing countries such as those in WCA, this would confer little benefit, nor would it inflict much damage on the offending country. In this

⁴⁵ For a detailed discussion on such concerns vis-à-vis the DSU, see Shaffer, Mosoti and Qureshi (2003) 'Towards a Development-Supportive Dispute Settlement System in the WTO'.

regard, the controversial issue of temporary monetary compensation rises once again to the fore.

As discussed earlier, one of the often-cited problems in the proposal for monetary compensation is the lack of any legal precedent for it in GATT/WTO history. However, as noted in a recent ILEAP (2004) legal analysis on the topic, with discussions surrounding monetary compensation pre-dating the drafting of the DSU, the lack of its explicit exclusion would appear to be an implicit recognition that such compensation was at the very least a potential outcome should it be so deemed in a dispute ruling. Furthermore, such considerations have gained weight once again in the context of the Doha-mandated DSU review. In other words, while it would be a challenging position to argue, sufficient legal grounds for monetary compensation would seem to exist.

The Brazilian case could also offer guidance that may render a new case less difficult (and expensive) to undertake. For example, having already been deemed to cause serious prejudice in the Brazil ruling, should sufficient reforms in the US not be forthcoming (due perhaps in part to a negotiated agreement between the US and Brazil on compliance), it would likely be easier to prove they continue to be a source of adverse effects to other countries. Indeed, while not having based its ruling on the existence of serious prejudice to other Members, the Panel did take such allegations as ‘evidentiary support’ (WTO 2005b). Thus it would seem plausible for other such Members to pursue a new case based on similar evidence.

For the EU, while being in a net cotton-importer position, and thus not having the same ability to influence world prices, a serious prejudice claim in terms of price depression would be difficult to pursue. However, vis-à-vis WCA and the EU, with the analysis offered by Gillson et al. (2004) on the disproportionate effect of EU subsidies on WCA producers due to their close competition in similar markets, an argument for the cause of serious prejudice resulting from displaced imports could be an alternative avenue. Such an approach however would need to be tempered by the EU reforms touched on above. As such, it would take some time before relevant analysis could be undertaken to determine whether a case would still exist.

4.4. Systemic commodity issues

Global cotton subsidy reforms and associated compensation pending its achievement, along with technical and financial assistance, are but a few elements of a much broader trade-related primary commodity strategy required to address the systemic problems related to dependence on cotton production and primary commodity dependence more generally. Indeed such dependence is closely linked to what UNCTAD (2002) has termed the ‘international poverty trap’, whereby the increasing marginalisation of commodity-dependent developing countries (CDDCs) in world trade, along with their continued dependence on a weak and slow growing primary commodity sector exhibiting declining real commodity prices and high price volatility works to reinforce generalised poverty and contribute to a vicious low income-savings/investment-productivity trap. As a result, these countries are hard-pressed to pursue export diversification, which via learning-related externalities can contribute to mitigating price-associate risks and the upgrading of productive capacities, thus catalysing more dynamic economic growth.

While a comprehensive review of these issues is beyond the scope of the current paper, and has been well documented, for example in a recent UNCTAD (2003b) publication titled ‘Economic Development in Africa: Trade Performance and Commodity Dependence’, we touch briefly on some key areas below so as to highlight the larger picture in which subsidy reform is situated. We focus in particular on the need to address the long-term decline and volatility of cotton prices and barriers to market access and market entry.

On the long-term decline and volatility of cotton prices (as discussed in section 2.2 above) we underscore the need to develop international mechanisms to help stabilise prices and thus facilitate more predictable economic management. Price volatility in particular, which is said to arise largely due to supply conditions, can greatly increase the level of economic uncertainty in the economy and as a result hamper macroeconomic management and frustrate investment decisions. With respect to cotton, while supply concerns have been a factor (for example, the 2002/03 price increase resulting from a poor crop in China), the analysis above shows clearly that

subsidies have also played a key role (we recall the observation noted earlier by Baffes (2004) that cotton price volatility increased post-1985 when the US moved from supply management to price support measures to stabilise farmer incomes).

Declining prices have been attributed to both demand and supply factors. On the demand side, we find the ideas promoted by Prebisch and Singer in the 1950s and how the low income elasticity of demand for primary commodities relative to manufactures (i.e. that increases in income lead to slower demand growth for primary commodities than for manufactures) leads to both declining long-term primary commodity prices and thus a deteriorating terms-of-trade (i.e. a lower purchasing power for imports derived from primary commodity exports). More recently, UNCTAD (2003b) has expounded a supply-side explanation, pointing to structural oversupply resulting from new high-productivity producers⁴⁶ (e.g. Asia in tropical beverages) as well as subsidies to high-cost producers. Cotton is of course exemplary of the latter – although remedies to remove subsidies and provide compensation alone will not rectify the matter (as they pre-date the recent rise in US and EU subsidies).

With decreasing and uncertain revenues⁴⁷, less foreign exchange⁴⁸ to import productivity-enhancing goods and payoff debts⁴⁹, alongside lower levels of investment⁵⁰, many CDDCs are thus confronted with widening savings, foreign exchange and fiscal gaps, higher debt loads and increasing difficulties to access international finance. Alongside other national and international economic policymaking reforms⁵¹, these difficulties thus highlight the far-reaching benefits that mechanisms to stabilise commodity prices could deliver.

⁴⁶ This relates to the ‘fallacy of composition’, whereby a small commodity producer may be able to increase production without affecting world prices and thus, *ceteris paribus*, increase export earnings; whereas many producers proceeding in this manner will work to depress the world price and lower unit revenues for all. Of note, a similar trend is now said to be occurring in low-skilled manufactures.

⁴⁷ The World Bank (2000) suggest losses (1970-1997) for African non-oil CDDCs (excluding S.Africa) exceeding 110 percent of their combined 1997 GDP and 68 percent of cumulative net resource flows (cited in UNCTAD 2003b).

⁴⁸ Razzaque et al. (2004) estimate the average foreign exchange losses for 1995-2000 for the LDCs alone at between 946 and 2181 billion \$USD. For details on the estimation procedures, see Razzaque et al. 2004, Ch. 4

⁴⁹ See Nissanke and Ferrarini (2001) for a discussion on the commodity-debt relationship.

⁵⁰ UNCTAD (2003b, citing UNCTAD 2001) notes that the investment ratio would have been on average 6 percentage points per annum had terms-of-trade losses for non-fuel CDDCs not occurred.

⁵¹ UNCTAD (2003a) highlights the following possible policy measures: stabilization of real exchange rates; better management and control of capital flows; debt reduction (including debt write offs) for HIPC; financing for diversification, particularly in LDCs and Africa; more effective and wider

In this regard, there has been renewed interest in recent years to revisit the potential benefits of producer-consumer or producer-producer commodity arrangements to manage the demand and/or supply (and by extension price) of traded commodities. While there are a number of legitimate concerns regarding such mechanisms, not the least of which is the often dismal history of previous International Commodity Organisations, this does not preclude the potential for new approaches to improve their effectiveness and ensure a better accounting of current political and economic realities (UNCTAD 2003a). Indeed, with respect to cotton, there has never been an attempt at supply management, making it perhaps an ideal candidate for a new initiative, with no historical baggage to overcome.

Another key area requiring attention if competitive cotton producing developing countries are to maximise the benefits of their competitive advantage in cotton production relates to market access and entry for cotton and higher value-added cotton products. Market access issues include traditional trade subjects, such as the subsidy considerations dealt with in this paper, as well as tariff peaks and escalations (which can impede value-addition in the producing countries) and non-tariff barriers (NTBs), such as market defence measures (anti-dumping and safeguards), product standards and health and food safety regulations. While MFN cotton import tariffs are generally low for most countries⁵², there are increased market access restrictions with processing. Quantitative restrictions on textiles (previously under the now-expired ATC or the safeguards that have mostly replaced it) typify such treatment that can impede the diversification out of strictly cotton production.

Of greater importance in the cotton sector however are market entry issues, which often deal with the monopsony and oligopsony power in purchasing and distribution channels resulting from the integration of multinational firms that effectively control international trade for specific commodities, as well as the product quality standards

coverage of compensatory finance; use of risk management instruments; and the consideration in the structural adjustment and stabilization programmes of the implications of competitive devaluation for international commodity prices, due to the potential of fallacy of composition.

⁵² For example, the EU has no import tariff on cotton, while the US¹ is fairly low (at 14 percent). On the other hand, some exporting countries who have large textile sectors do have high tariffs – with China's 90 percent tariff standing as the lone above 40 percent. (Baffes 2003; Gillson et al 2004).

demanded by consumers to gain entry to specific markets.⁵³ Although far less concentrated than other commodities such as cocoa and coffee, the role of international cotton traders (who mediate between producers and processors) is often highlighted. According to an ICAC survey, Gillson et al. (2004) report that the 19 largest companies accounted for approximately 33 percent of global production in 2003, with expanded activities in the area of inventory storage and helping ensure stable supply availabilities. As a result of higher transaction costs stemming from these and other new activities, traders have increasingly looked to pass them onto captive producers, resulting in lower farm-gate prices and lower domestic earnings (Gibbon 2003).

In addition, with a greater focus on new quality standards – the ‘High Volume Instrument’ (HVI) classification (ibid) – traders are increasingly looking to suppliers who can consistently provide uncontaminated, high quality cotton grades, and are willing to pay a premium on the world price in return. These new exacting standards, combined with instances of contamination that have damaged the image of WCA cotton in recent years, has resulted in their cotton being traded at a discount rather than at the premium price it should command (due to its otherwise high quality) (Estur 2005).

In light of these constraints on market access and market entry, a wide-range of international efforts needs to be considered, including addressing specific measures within WTO rules (such as tariff escalation, market defence measures, and TBT and SPS disciplines), as well as mechanisms to promote better integration into global commodity chains. The development of niche markets and alternative marketing channels (e.g. fair trade networks) has also been identified in this regards (UNCTAD 2003a). Domestically, efforts to upgrade production structures and build the capacities to develop quality assurance and testing facilities could prove highly beneficial.

⁵³ This area is addressed most directly in the global commodity chain literature, which delves into the range of activities and actors from primary production to final consumption in specific commodity value chains, considering the linkages that bind them and the distribution of value-added between them. See Gibbon (2003) and <http://www.globalvaluechains.org/>.

However, to be able to undertake such activities requires a large pool of investment resources. Indeed, the lack of investment resources underlies two other key systemic issues requiring attention, namely low productivity in the cotton sector (and CDDC economies more generally) and the poor access to technology and finance to facilitate these and other improvements in competitiveness and stimulate export diversification. In this respect, the welcome efforts to provide greater technical and financial assistance to cotton producing developing countries reviewed earlier are essential. To be effective however, the resources allocated would need to be greatly augmented.

Serving as such to illustrate just some of the systemic challenges facing CDDCs and cotton-producing developing countries in particular, we can see that while forming only one part of the solution, subsidy reform is essential. By allowing developing countries to best take advantage of their competitive advantage in cotton production, they would be far better equipped to generate at least a portion of the investment resources required to begin addressing these systemic concerns. To that aim, compensation pending these reforms becomes all the more important.

We turn now, in conclusion, to consider some potential deliverables from the forthcoming WTO Ministerial Conference in Hong Kong.

5. Looking ahead to Hong Kong

The discussion above demonstrates that despite both economic and moral arguments supporting immediate reforms in the cotton sector, political reality dictates that the process of negotiating meaningful agricultural reform in the WTO, including for cotton, will be a long one, with little in the way of serious implementation prior to 2008-09. While recent calls have been heard by EC Trade Commissioner Peter Mandelson that Hong Kong should deliver a “tailored development package to the poorest Members” as part of a down payment for what lies ahead, most Members’ ambitions would seem to be looking rather for a roadmap with a menu of options on how to proceed (with talk of a follow-up Ministerial sometime in 2006). The proponents of the Cotton Initiative however, have remained adamant that a bad deal on cotton implies no deal in Hong Kong at all.

Perhaps in response to this, and the spotlight being shone on cotton from various stakeholders, the language for cotton in the initial Draft Ministerial Text for Hong Kong has changed in the most recent version. The initial draft text (WTO 2005d) simply envisaged a reaffirmation of the “commitment to ensure prioritization of the cotton issue” and to establish modalities in conformity with the July Package (see WTO 2004a). However, the latest iteration (WTO 2005e) has opened a window for the adoption of more specific modalities, bracketing the previous sentence (implying the language has not been agreed upon), and including additional bracketed language that would see Members taking in Hong Kong “an explicit decision on cotton on an "early harvest" basis” and the adoption of an as-yet empty list of modalities.

With this in mind, we close with some food for thought on possible deliverables on cotton in Hong Kong. We underscore that if explicit numbers and dates are not feasible at this time, some degree of modalities ensuring an accelerated treatment of cotton (predicated on a baseline to be agreed in the future) could serve as a foundation for future building.

5.1. What can be achieved in Hong Kong?

The issue of duty- and quota-free market access for cotton – and more importantly for cotton-related products (i.e. textiles) – has long been a source of divergence at the WTO and continues to be in this context. In the mid-year African Group proposal (WTO 2005a), the proponents called for bound duty- and quota-free market access for cotton and cotton by-product exports from LDC cotton producers and net-exporters. While garnering some support from the EU, who favoured multilateralising the duty- and quota-free access to LDC raw cotton exports they already provide under EBA, the African proposal has been strongly opposed by the US, as well as Japan and Canada. Notably, in line with the difficulties in securing similar market access for LDC exports via the LDC work programme⁵⁴, or as part of the review of special and differential treatment (SDT) provisions⁵⁵, the US has historically expressed concern over potential injury resulting from a surge of textile imports from Bangladesh (highlighting in addition the potential damage to competing developing country textile exporters).

One possible avenue of addressing these concerns could be the granting by all developed countries, as well as, wherever possible, all non-LDC developing countries, of duty- and quote-free access for cotton and related by-product exports emanating from net-cotton-exporting LDCs. In this way, Bangladesh and other potential cotton producing LDCs who develop a strong textiles sector are effectively placed outside the group of beneficiaries.⁵⁶

In terms of the reduction/elimination of trade-distorting domestic support and export subsidies, a key sticking point continues to be the timeline for it to be started and completed. As proposed above, one avenue for investigation is a structure around which specific dates can be agreed upon in the future. To this end, in the context of trade-distorting domestic support, the WCA producers have proposed a three-step

⁵⁴ See paragraph 41 of the revised Draft Ministerial Text.

⁵⁵ See Annex F of the revised Draft Ministerial Text, LDC proposal 36.

⁵⁶ In the context of the negotiations on SDT, Switzerland has proposed language that allows countries with such concerns to put 99 percent of tariff lines under duty- and quote-free access, thus providing a 1 percent exemption for what in effect would be 'sensitive products'. To-date however, this has also been rejected.

approach of 80 percent on the day of implementation of the round, an additional 10% after 12 months and the last 10% a year later. However, with the political difficulties surrounding the reform of domestic support measures in the US discussed earlier, the degree of ‘front-loading’ proposed here may be prove too ambitious. An alternative construction could see a combination of an immediate early harvest, with a lower year 1 reduction and higher year 2 and 3 reductions (for which in the face of temporary compensation, could be a much easier scenario for the WCA proponents to agree to).

In addition, the proponents may want to pursue – at least in principle – agreement from Members to develop at a future date, cotton-specific mechanisms to mitigate reforms being undertaken simply as an exercise of shifting expenditures to support categories with lower reduction commitments (such as the blue and green boxes). As touched on earlier, cotton-specific commitments based on the categorisation of existing support programme notifications (i.e. before ‘box-shifting’ can occur) may prove helpful in this regard. Other possible deliverables include agreement that the envisaged reductions in the total AMS and/or *de minimis* threshold will be a fixed percentage greater for cotton-specific measures (for example, by agreeing that whatever the horizontal reductions in this area to be implemented as part of the round, cotton-specific reductions will be *x* percentage greater).

A further deliverable for Hong Kong on subsidy reduction could be finding agreement that in light of the high levels of support extended to cotton producers in the US and EU in either of 1995-00 or 1999-01, an alternative methodology will be established such that the combination of the base year employed and the reduction commitments accepted ensure real and meaningful cuts in the level of current support are implemented.

In effect, while perhaps not providing the explicit details on cotton reforms that the proponents had sought, provisions such as those above offer concrete and binding commitments that could help operationalise the mandate to address cotton “ambitiously, expeditiously and specifically”.

On the issue of temporary monetary compensation, there appears to have been little movement to-date – with no mention of the issue in either version of the Draft

Ministerial Text. We emphasise however, in the context of the arguments offered throughout this paper, that Members should re-consider accepting responsibility for the injury that will be caused to competitive cotton producers pending the elimination of distortions in cotton trade. To this end, they should agree to recommence discussions under the auspices of the WTO for such provision – even if it were to be agreed *ex ante* that such compensation would be delivered outside the WTO framework.

5.2. If nothing in Hong Kong – then what?

If nothing meaningful on cotton is presented in Hong Kong, the WCA proponents of the Cotton Initiative have indicated that they ‘cannot be held responsible’ if they are unable to accept an agreement on the broader negotiations. Despite this holding some element of pre-Ministerial positioning, using what is considered strong language in the WTO, the proponents are letting it be known that consensus towards moving the Doha ‘Development’ Agenda to its next phase will prove elusive once again if their legitimate concerns are not adequately addressed. If nothing else, such a move signifies (at least in principle)⁵⁷ that even the smallest of WTO Members can employ the mechanisms provided for in the WTO towards these aims.

Furthermore, as outlined in the previous section, should the negotiations aimed at balancing what is arguably one of the most distorted areas of international trade prove unable to deliver results, dispute settlement remains at their disposal. Ironically, with the disastrous negotiating outcome upon which this course of action would likely be based, the environment could be ripe (in light as well of the expired Peace Clause) for a wide range of challenges to US and EU subsidies – cotton and otherwise.

⁵⁷ We note ‘in principle’, recognising that taking a stand at the WTO to block consensus is likely not without implications vis-à-vis bilateral relationships with the major trading powers (for example, in terms of donor relations, etc.).

6. Tables and Figures

Figure 1 - Cotlook A Index (Annual)

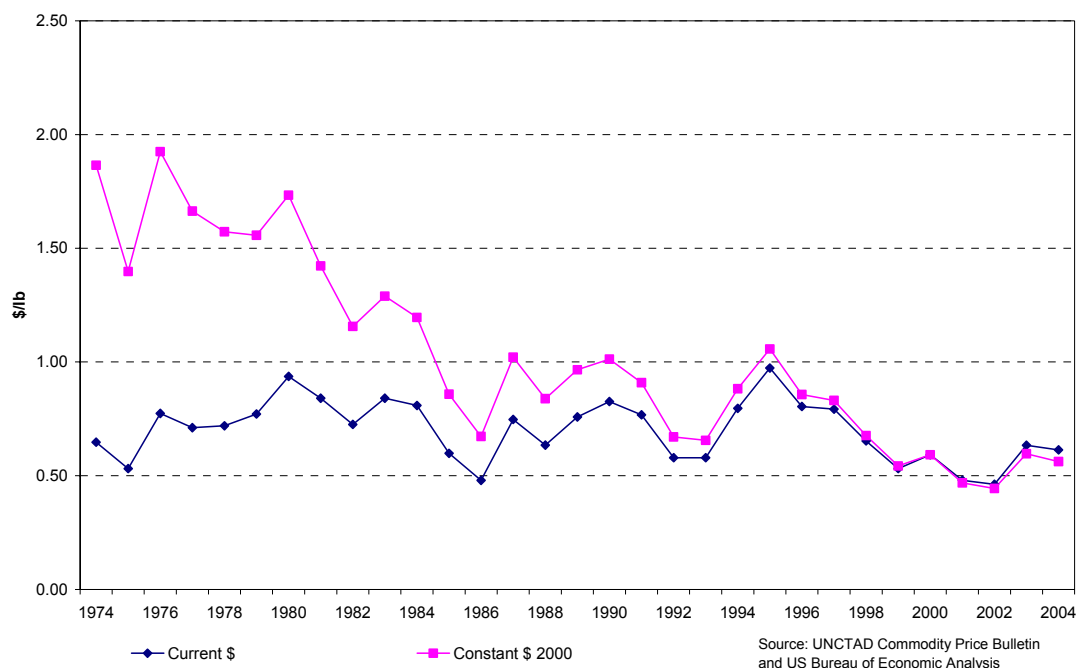


Table 1 – Impact of eliminating elements of US cotton support programme on world cotton prices (% change from baseline, average 99/00-07/08)

<i>Programme type</i>	<i>% increase in World Price</i>	<i>Type of support measure</i>
Marketing loan payments	3.61	Price-contingent domestic support
User marketing (Step 2) payments	2.95	Price-contingent export subsidy
Market loss assistance/counter-cyclical payments	1.46	Price-contingent domestic support
Crop insurance payments	1.27	Non price-contingent domestic support
Export credit guarantees	1.03	Non price-contingent export subsidy
Production flexibility contracts/direct payments	0.60	Non price-contingent domestic support
Interaction between programmes	0.66	
All subsidies	11.58	

Source: Table I.4 Sumner (2003) and Table 5 Goreux (2004a)

Table 2 – Estimated impacts of developed country subsidy removal on world prices, EU and US production levels, and the resulting increase in WCA export earnings

	Estimated price without subsidies (US\$/lb)	Effect on price (%)	Production fall in the United States (%)	Production fall in the European Union (%)	Prejudice to WCA farmers (US\$ million) ⁵
ODI (2004) ¹					
S/U	0.675	18 - 28	15.2	26.6	266.5
F/U	0.688	20	8.3	19.8	93.8
S/D	0.70	22	13.6	25.2	354.6
F/D	0.732	28	1.5	8.9	133.5
Goreux (2003)	0.589 - 0.649	2.9 - 13.4	2.2 - 14.7	10 - 48	37 - 254
ICAC (2002)	0.742	29.7	-	-	274
ICAC (2003) ²					
2000/01	0.742	21	-	-	-
2001/02	0.738	72.4 ⁴	-	-	504
FAO (2004)	0.591 - 0.60	2.3- 5.0	7.4 - 14.2	16.1 - 31.7	30
FAPRI (2002)	-	11.4	6.7	70.5	90.37
Reeves <i>et al</i> (2001) ²	0.474	10.7	15.9	na	76
Sumner ³ (2003)	0.644	12.6	29.1	na	116
Tokarick (2003)	0.588	2.8	8.6	na	26

Source: Based on Shui (2004)

¹ The ODI studies run four model scenarios: S=Single Market; F=Fragmented market; U = Uniform elasticity; D = Differentiated elasticity. For the segmented market assumption, the world price is an average across segments.

² All studies use 2000/01 as the simulation year data except ICAC (2003) and Reeves (2001) which use 2001/02 data. Actual world price in 2000/01 = US\$0.572/lb Actual world price in 2001/02 = US\$0.418/lb.

³ Removal of US support only

⁴ The value of 72 percent reported in ICAC is considered by many to be an outlier due to the very low world price during the simulation year – see discussion on base year below.

⁵ Where the prejudice to WCA farmers is not explicitly stated in a study, the value in the table is estimated by using a cotton supply equation for WCA to determine additional export earnings generated by the increase in world price.

Source: Table 1, FAO (2004)

Table 3 – Key assumptions made in the reviewed studies

	Demand elasticity	Supply elasticity	Simulation from base year	Market segmentation assumed	Model includes stocks
ODI (2004)	-0.1	0.36 to 0.6	2000/01	Y	N
Goreux (2003)	-0.1 to -0.5	0.15 to 0.90	2000/01 ¹	N	N
ICAC (2002)	-0.1	0.47	2000/01	N	N
FAO (2004)	-0.75 to -1.25	0.2 to 1.25	2000/01	N	N
FAPRI (2002)	Not specified	Not specified	Average 2002/03 – 2011/12	N	N
Reeves <i>et al</i> (2001)	-0.3	0.8	2001/02	N	N
Sumner (2003)	-0.2 to -0.47	0.14 to 0.6	2000/01	N	Y
Tokarick (2003)	-0.56 ²	0.41 ²	2000/01	N	N

Source: based on Shui (2004).

¹ Goreux uses a five year average for the base period.

² Tokarick's elasticities are for the United States only.

Source: Table 2, FAO (2004)

**Table 4 – US Cotton Programmes and Summary of Panel/Appellate Body Report
(US – Subsidies for Upland Cotton: WT/DS267/R & WT/DS267/AB/R)**

Programme	Expenditure, US\$ annual avg. 99-02	Classification (as notified)	Panel/AB ruling on classification and/or serious prejudice	WTO discipline(s) under which ruling made	Remedy
1. Marketing Loan (gain/deficiency) Payments	\$1.4 billion	Amber box	<ul style="list-style-type: none"> • Amber box • Caused significant price suppression on world market 	SCM 6.3(c); 5(c)	Remove the adverse effects or withdraw the subsidy
2. User Marketing (Step 2) Payments [to i) users of domestic cotton and ii) cotton exporters]	\$161 million	Amber box	<ul style="list-style-type: none"> • Caused significant price suppression on world market • Payments constituted prohibited subsidy (i.e. not Amber box): <ul style="list-style-type: none"> - import substitution subsidy (domestic); - export subsidy not included in the US schedule (export) 	SCM 6.3(c); 5(c) SCM 3.1(b); 3.2 AoA 3.3; 8; SCM 3.1(a); 3.2	Remove the adverse effects or withdraw prohibited subsidies by 1 July 2005
3. Market Loss Assistance Payments (1999-2001)/Counter-Cyclical Payments (2002-2007)	combined \$797 million	Amber box	<ul style="list-style-type: none"> • Amber box • Caused significant price suppression on world market 	SCM 6.3(c), 5(c)	Remove the adverse effects or withdraw the subsidy
4. Crop Insurance Payments	\$197 million	Amber box	<ul style="list-style-type: none"> • Do not cause significant price suppression on world markets 	SCM 6.3(c); 5(c)	None
5. Export Credit Guarantees	\$324 million (cotton products ⁵⁸ ; Fiscal Year)	Not notified	<ul style="list-style-type: none"> • Credit guarantees for cotton (and other products) are export subsidies not included in the US Schedule (rice export subsidy exceeded its scheduled level) 	AoA 10.1 SCM Annex I, item (j); 3.1(a); 3.2	Withdraw prohibited export subsidies by 1 July 2005
6. Production Flexibility Contract Payments (1999-2001)/Direct Payments (2002-2007)	combined \$570 million	Green box	<ul style="list-style-type: none"> • Amber box – not eligible for green box due to land use restrictions • Do not cause significant price suppression on world markets 	AoA 13(a); Annex 2, para. 6(b) SCM 6.3(c); 5(c)	Re-notify domestic support
7. Cottonseed Payments	\$78 million	Amber box	<ul style="list-style-type: none"> • Do not cause significant price suppression on world markets (only 2000 considered) 	SCM 6.3(c); 5(c)	None

Source: This table is based on information extracted from Josling (2005), Halverson Cross (2005), WTO (2004b & c) and USDA (various).

⁵⁸ As noted by Brazil in the case, this amount includes only those guarantee applications received for cotton-specific allocations and not those (which possibly also included cotton) listed under the 'all commodities' allocations. As such, it is likely an underestimate.

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