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UNITED STATES – SUBSIDIES ON UPLAND COTTON

Request for Consultations by Brazil

The following communication, dated 27 September 2002, from the Permanent Mission of Brazil to the Permanent Mission of the United States and to the Chairman of the Dispute Settlement Body, is circulated in accordance with Article 4.4 of the DSU.

Upon instruction from my authorities, the Government of Brazil hereby requests consultations with the Government of the United States pursuant to Articles 4.1, 7.1 and 30 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement), Article 19 of the Agreement on Agriculture, Article XXII of GATT 1994 and Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU).

The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton¹, as well as legislation, regulations, statutory instruments and amendments thereto providing such subsidies (including export credits), grants, and any other assistance to the US producers, users and exporters of upland cotton ("US upland cotton industry"). The measures include the following:

- Domestic support subsidies provided to the US upland cotton industry during marketing years 1999-2002;²
- Export subsidies provided to the US upland cotton industry during marketing years 1999-2002;³
- Subsidies provided contingent upon the use of US upland cotton;
- Subsidies and domestic support provided under the Farm Security and Rural Investment Act of 2002 (FSRIA), including the regulations, administrative procedures and other measures implementing FSRIA related to marketing loans, loan deficiency payments (LDPs), commodity certificates, direct payments, counter-cyclical payments, conservation payments (to the extent they exceed the costs of complying with such programs), Step 2 certificate

¹ Except with respect to export credit guarantee programs as explained below.

² The "marketing" year for upland cotton runs from 1 August through 31 July. For example, marketing year 2001 started on 1 August 2001 and ended on 31 July 2002. Brazil, as does the United States in its official USDA documents, treats "marketing year" to mean the same thing as "crop year".

³ The adverse effects and serious prejudice and threat thereof created by the measures in the marketing years 1999-2007 also exists for the corresponding (somewhat overlapping) US fiscal years 2000-2008. The US government fiscal year runs from 1 October to 30 September. For example, the fiscal year for 2001 started on 1 October 2000 and ended on 30 September 2001.

program payments, export credit guarantees, and any other provisions of FSRIA that provide direct or indirect support to the US upland cotton industry;

- Subsidies and domestic support provided under the Agricultural Risk Protection Act of 2000 and any other measures that provide subsidies relating to crop, disaster or other types of insurance to the US upland cotton industry;
- Subsidies and domestic support provided under the Federal Agricultural Improvement and Reform Act (FAIR Act) of 1996, and programs under the FAIR Act or amendments thereto relating to marketing loans, loan deficiency payments, commodity certificates, production flexibility contract payments, conservation payments, Step 2 certificate program payments, export credit guarantees, and any other FAIR Act provisions providing direct or indirect support to the US upland cotton industry;
- Export subsidies, exporter assistance, export credit guarantees, export and market access enhancement to facilitate the export of US upland cotton provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, and the Step 1 and Step 2 certificate programs, among others;
- Subsidies provided to the US upland cotton industry under the Agricultural Act of 1949 as amended;
- Export subsidies provided to exporters of US upland cotton under the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 ("ETI Act");
- Subsidies provided under the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of 2002 (November 2001), the Crop Year 2001 Agricultural Economic Assistance Act (August 2001), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2001 (October 2000), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2000 (October 1999), and the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 1999 (October 1998);
- All subsidies or support measures benefiting upland cotton that have trade-distorting effects or effects on production by the US upland cotton industry, or that have an effect of providing price support for upland cotton, or that are otherwise not exempt from the reduction commitments of the United States, as described in Annex 2 of the Agreement on Agriculture, because they do not meet the policy-specific criteria and conditions set out in paragraphs 2-13 of Annex II of the Agreement on Agriculture (*i.e.* they are not so-called green box subsidies);
- Export subsidies, domestic support, and other subsidies provided under regulations, administrative procedures, administrative practices and any other present measures, amendments thereto, or future measures implementing any of the measures listed above, that provide for or facilitate the payment of domestic support, export subsidies, and other subsidies for the production, use and/or export of US upland cotton and upland cotton products.

The Government of Brazil considers that these measures are inconsistent with the obligations of the United States under the following provisions:

1. Article 5(c) of the SCM Agreement;
2. Article 6.3(b), (c) and (d) of the SCM Agreement;
3. Article 3.1(a) of the SCM Agreement including item (j) of the Illustrative List of Export Subsidies in Annex I thereto;
4. Article 3.1(b) of the SCM Agreement;
5. Article 3.2 of the SCM Agreement;
6. Article 3.3 of the Agreement on Agriculture;
7. Article 7.1 of the Agreement on Agriculture;
8. Article 8 of the Agreement on Agriculture;
9. Article 9.1 of the Agreement on Agriculture;
10. Article 10.1 of the Agreement on Agriculture; and
11. Article III:4 of GATT 1994.

Brazil is of the view that the US statutes, regulations, and administrative procedures listed above are inconsistent with these provisions as such and as applied.

The United States has no basis to assert a defense under Article 13(b)(ii) of the Agreement on Agriculture that the domestic support measures listed above are exempt from action based on Articles 5 and 6 of the SCM Agreement, because these measures provide support to upland cotton in marketing years 1999-2002 in excess of the support decided by the United States in the 1992 marketing year. Similarly, the United States has no basis to assert a defense under Article 13(c)(ii) of the Agreement on Agriculture that the export subsidies listed above are exempt from action based on Article 3, 5 and 6 of the SCM Agreement, because these export subsidies do not conform fully to the provisions of Part V of the Agreement on Agriculture, as reflected in the Schedule of the United States.

The measures listed above are subsidies because in each instance there is a financial contribution by the US government, or an income or price support in the sense of Article XVI of GATT 1994, and a benefit is thereby conferred within the meaning of Article 1.1(a) and (b) of the SCM Agreement. Each of the listed subsidies is specific to US producers of primary agricultural products and/or to the upland cotton industry within the meaning of Articles 2.1 and 2.3 of the SCM Agreement.

The use of these measures causes adverse effects, *i.e.* serious prejudice to the interests of Brazil:

- The effect of the measures is significant price depression and price suppression in the markets for upland cotton in Brazil and elsewhere during marketing years 1999-2002 in violation of SCM Articles 5(c) and 6.3(c).
- The effect of the measures is to displace or impede exports of Brazilian upland cotton in third country markets during marketing years 1999-2002, in violation of Articles 5(c) and 6.3(b) of the SCM Agreement.
- The effect of the measures is to increase the world market share of the United States for upland cotton in marketing year 2001 as compared to the average share of the United States between marketing years between 1998-2000, and by increasing its world market share for the production of upland cotton in the period from marketing year 1985 (the first year in which LDP and marketing loan payments were made for upland cotton) to marketing year

2001 from 16.7 to 20.6 percent in violation of Articles 5(c) and 6.3(d) of the SCM Agreement.

The statutes, regulations, and administrative measures listed above and the subsidies they mandate threaten – as such and as applied – to cause serious prejudice to the interests of Brazil as follows:

- By mandating conditions that will result in continued depressed and suppressed upland cotton prices for marketing years 2002 through 2007 through the guaranteed payment of subsidies to the US upland cotton industry, which artificially increases and/or maintains high-cost US upland cotton production in violation of SCM Articles 5(c) and 6.3(c); and
- By mandating conditions that will result in over-production of high-cost US upland cotton, which will continue to displace and impede Brazil's export market share in the world market and specific national markets for upland cotton, in violation of SCM Articles 5(c) and 6.3(b).

With respect to the Step 2 program, Brazil believes that the program as such and as applied to provide payments to exporters of US upland cotton is inconsistent with Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture, and with Articles 3.1(a) and 3.2 of the SCM Agreement. Brazil further believes that the program, as such and as applied to provide payments to US domestic mill users of US upland cotton, are inconsistent with Article 3.1(b) of the SCM Agreement, and Article III:4 of GATT 1994. Step 2 payments are actionable subsidies for the purpose of Brazil's claims under Articles 5 and 6.3 of the SCM Agreement.

Regarding export credit guarantees, export and market access enhancement provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, Brazil is of the view that these programs, as applied and as such, violate Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture and are prohibited export subsidies under Article 3.1(a) and item (j) of the Illustrative List of Export Subsidies included as Annex I to the SCM Agreement. Subsidies provided under these programs are also actionable subsidies for the purpose of Brazil's claims under Article 6.3 of the SCM Agreement.

Articles 4.2 and 7.2 of the SCM Agreement together require that this request for consultations include a statement of available evidence (1) with regard to the existence and nature of the subsidies in question and (2) the adverse effects and serious prejudice to the interests of Brazil. This letter identifies the existence and nature of the subsidies, and further evidence is provided in the annex to this letter.

The Government of Brazil reserves the right to request the United States to produce information and documents regarding the measures in question and their effect on the interests of Brazil, during the consultation process. The Government of Brazil also reserves the right to address additional measures and claims under other WTO provisions during the course of the consultations.

My authorities look forward to receiving in due course a reply from the United States to this request. Brazil is ready to consider with the United States mutually convenient dates to hold consultations in Geneva.

ANNEX

**Statement of Available Evidence With Regard
to the Existence and Nature of the Subsidies in Question
and the Serious Prejudice Caused to the Interest of Brazil**

1. Brazil's request for consultations dated 27 September 2002 identifies the prohibited and actionable subsidies that are the subject of this request for consultations.
2. The evidence set out below is evidence available to Brazil at this time regarding the existence and nature of those subsidies, and the adverse effects caused by them to the interests of Brazil. It reflects the presently available evidence regarding the claims reflected in Brazil's request for consultations and is supported by documents that are described and set out in United States Department of Agriculture (USDA) and non-governmental internet locations set out in paragraph 4 below. Brazil reserves the right to supplement or alter this list in the future, as required.
3. The evidence presently available to Brazil includes the following:
 - US producers of upland cotton received domestic support in excess of 100 percent of the US crop value in marketing year 2001;
 - US domestic and export support subsidies to upland cotton in marketing year 2001 exceeded \$4 billion – far greater than the value of total US production;
 - Compared with marketing year 1992, US Government subsidies to US producers of upland cotton have increased significantly, particularly for the 1999 and 2001 marketing year;
 - The provisions of the 2002 Farm Bill mandate the payment of subsidies considerably in excess of those provided in the 1996 FAIR Act, including a new counter-cyclical payment program providing for more than \$1 billion for marketing year 2002 at current market prices for upland cotton. The 2002 Farm Bill provides similar (although increased) payments as the FAIR act in the form of a "direct payment" program (a successor to production flexibility payments) and continues largely unchanged the loan deficiency payments, marketing loans payments, crop insurance payments, and the Step 2 program and other export subsidy programs that provided support to the US upland cotton industry prior to passage of the 2002 Farm Bill;
 - For a significant number of US producers of upland cotton, total cost of production in 2001 (and from 1991 through 2000) was well *above* the US market price of upland cotton;
 - Thus, without the benefit of US domestic and export subsidies, many US producers would not be able to produce upland cotton without sustaining a significant loss; current price projections for marketing years 2003-2007 indicate that US upland cotton prices are expected to remain well below the US cost of production;
 - With upland cotton prices declining over the 4-year period from 1998 through 2001, US production increased from 14 million tons in marketing year 1998 to a record 20.3 million metric tons in marketing year 2001;
 - In marketing year 2001 the United States was the world's largest exporter of upland cotton, with a 38 percent share. It is expected that the United States will remain by far the world's largest exporter of upland cotton in marketing year 2002;

- The volume of US exports of US upland cotton increased significantly from 946.000 metric tons in marketing year 1998 to 1.829.000 metric tons in marketing year 2001, with 1.960.000 metric tons expected to be exported in marketing year 2002;
- The effect of the US subsidies over the period of marketing years 1999-2001 was an increase in production of US upland cotton, an increase in US exports, and a corresponding significant decrease in Brazilian, world, and US prices of upland cotton;
- US year-end surplus stocks of upland cotton in marketing year 2001 increased steadily between marketing years 1999-2001 with the additional surplus creating a depressing and suppressing effect on US and world prices;
- Brazilian upland cotton is like or has characteristics closely resembling US upland cotton, is used interchangeably by customers in third country markets with US upland cotton and competes in the same markets for the same customers. Thus, the overproduction of US upland cotton suppresses and depresses the price that Brazilian producers can obtain for their upland cotton on the world and Brazilian market;
- Prices for upland cotton in Brazil follow trends created in the US and Northern European markets and experienced significant declines between marketing years 1999-2002;
- Brazilian production of upland cotton decreased between marketing year 2000 and 2001 from 939.000 to 718.000 metric tons;
- Prices for upland cotton in the Brazilian, worldwide, and other regional and third country markets were significantly depressed and suppressed over the period of marketing years 1999-2002 as a result of the effect of US subsidies;
- Prices for upland cotton in the Brazilian, worldwide, and other regional and third country markets continue to be suppressed in marketing year 2002 as a result of US subsidies;
- The world market share of the United States for upland cotton in marketing year 2001 increased over the average share of the United States between marketing years 1998-2000. In addition, the United States increased its world market share for the production of upland cotton in the period from marketing year 1985 (the first year in which LDP and marketing loan payments were made for upland cotton) to marketing year 2001 from 16.7 to 20.6 percent;
- The United States' notifications of subsidies to the WTO Committee on Agriculture provide information indicating that the loan deficiency payments (LDP), marketing loan gains, crop insurance programs, marketing loss payments, and Step 2 certificate payments made in connection with upland cotton are not "green" box payments;
- USDA econometric analyses demonstrate the actual or potential production enhancing effects for particular crops in the United States of LDP, marketing loan payments, crop insurance subsidies, and even production flexibility payments. Certain of these studies demonstrate the production enhancing effects of such subsidies on US production of upland cotton;
- Econometric studies by the International Cotton Advisory Committee, the World Bank, and the International Monetary Fund demonstrate that many of the US subsidies at issue in the consultation request have a price suppressive and depressive effect on prices of upland cotton and other crops;

- The US Step 1 and Step 2 programs, since their origin and up to the present, enhance the export competitiveness of US-produced upland cotton -- an effect consistent with the expressed purpose of such programs;
- US export credit guarantee programs have caused serious prejudice to Brazilian upland cotton producers by providing below-market financing benefits for the export of competing US upland cotton;
- US export credit guarantee programs, since their origin in 1980 and up the present, provide premium rates that are inadequate to cover the long-term operating costs and losses of the programs; in particular there were losses caused by large-scale defaults totalling billions of dollars that have not been reflected in increased premiums to cover such losses;
- The volume of production and export of lower-cost Brazilian upland cotton have been impeded by US subsidies that have built and maintained excess US production by higher-cost US producers;
- The estimated losses suffered by Brazil due to price suppressed or depressed by US subsidies to the US upland cotton industry are well in excess of \$ 600 million for marketing year 2001 alone including lost revenue, lost production, losses of related services, lost federal and state revenue, higher unemployment and losses in Brazil's trade balance.

4. The statistics, data and analytic documents supporting the summary of evidence above can be found in the following documents published by among others the US Department of Agriculture, the International Cotton Advisory Committee and the Food and Agriculture Policy Research Institute, University of Missouri as well as others:

US Department of Agriculture, Economic Research Service:

<http://www.ers.usda.gov>

- Comparison and Summary of 1996 and 2002 farm bills
<http://www.ers.usda.gov/Features/farmbill/titles/titleIcommodities.htm#c>
- Briefing on Cotton
<http://www.ers.usda.gov/briefing/cotton/>
- Cotton and Wool Outlook: Various Editions
<http://www.ers.usda.gov/publications/so/view.asp?f=field/cws-bb/>
- Factors Affecting the US Farm Price for Upland Cotton, Cotton and Wool Situation and Outlook, April 1998
- Cotton and Wool Outlook: Latest Statistical Information
<http://www.ers.usda.gov/briefing/cotton/Data/data.htm>
- Statistical Information of the Cotton and Wool Yearbook
<http://www.ers.usda.gov/data/sdp/view.asp?f=crops/89004/>
- 1996 FAIR Act Frames Farm Policy for 7 Years
<http://www.ers.usda.gov/publications/agoutlook/aosupp.pdf>
- US Farm Program Benefits: Links to Planting Decisions & Agricultural Markets
<http://www.ers.usda.gov/publications/agoutlook/oct2000/ao275e.pdf>
- Production and Price Impacts of US Crop Insurance Subsidies: Some Preliminary Results
http://www.ers.usda.gov/briefing/FarmPolicy/ffc_insurance.pdf
- Commodity Cost and Returns
<http://www.ers.usda.gov/data/costsandreturns/>
- Characteristics and Production Costs of US Cotton Farms
<http://www.ers.usda.gov/publications/sb974-2/>

- Analysis of the US Commodity Loan Program with Marketing Loan Provisions
<http://www.ers.usda.gov/publications/aer801/aer801fm.pdf>
- Agricultural Outlook December 1999: Ag Policy: Marketing Loan Benefits Supplement Market Revenues for Farmers
<http://www.ers.usda.gov/publications/agoutlook/dec1999/ao267b.pdf>
- Farm and Commodity Policy: 1996-2001 Program Provisions
<http://www.ers.usda.gov/briefing/FarmPolicy/1996malp.htm>
- Farm and Commodity Policy: Questions and Answers
<http://www.ers.usda.gov/briefing/FarmPolicy/questions/index.htm>
- Farm and Commodity Policy: Crop Insurance
<http://www.ers.usda.gov/briefing/FarmPolicy/cropInsurance.htm>
- Cotton: Background Issues for Farm Legislation
<http://www.ers.usda.gov/publications/CWS-0601-01/>
- Cotton Policy: Special Program Provisions for Upland Cotton
<http://www.ers.usda.gov/briefing/cotton/specialprovisions.htm>
- List of Studies Analyzing Market Effects of US Agricultural Policy
<http://www.ers.usda.gov/publications/tb1888/tb1888ref.pdf>
- Major Agricultural and Trade Legislation, 1933–1996
<http://www.ers.usda.gov/publications/aib729/aib729a3.pdf>

US Department of Agriculture, Farm Service Agency:

<http://www.fsa.usda.gov>

- Statistics on Price Support Loans and Loan Deficiency Payments
<http://www.fsa.usda.gov/pscad/>
- FSA Fact Sheets:
<http://www.fsa.usda.gov/pas/publications/facts/pubfacts.htm>
- Fact Sheet: Upland Cotton: Locking the Adjusted World Price (AWP) by Loan Deficiency Payments on Upland Seed Cotton
<http://www.fsa.usda.gov/pas/publications/facts/html/upcotlock00.htm>
- Price Support Programs
<http://www.fsa.usda.gov/dafp/psd/default.htm>
- Loan Deficiency Payment and Price Support Cumulative Activity
<http://www.fsa.usda.gov/pscad/answer82rnat.asp>

Congressional Budget Office Current Budget Projection:

<http://www.cbo.gov/showdoc.cfm?index=1944&sequence=0>

Food and Agriculture Policy Research Institute, University of Missouri:

http://www.fapri.missouri.edu/FAPRI_Publications.htm

International Cotton Advisory Committee:

<http://www.icac.org/icac/english.html>

- Cotton: Review of the World Situation August 2002
<http://www.icac.org/icac/CottonInfo/Publications/Reviews/english.html>
- Production and Trade Policies Affecting the Cotton Industry, November 2000
- Production and Trade Policies Affecting the Cotton Industry, September 2001
- Production and Trade Policies Affecting the Cotton Industry, July 2002
<http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20053593~menuPK:34463~pagePK:34370~piPK:34424~theSitePK:4607,00.html>
- Cotton: World Statistics
<http://www.icac.org/icac/CottonInfo/Publications/Statistics/statsws/english.html>

- Report from Brazil on Injury From Low Cotton Prices
- Survey of Cost of Production of Raw Cotton

World Trade Organization:

- US notification on Domestic Support for Marketing Year 1998 - G/AG/N/USA/36

International Monetary Fund:

- World Economic Outlook September 2002
<http://www.imf.org/external/pubs/ft/weo/2002/02/pdf/chapter2.pdf>

World Bank:

- Cotton Producers Face Losses Because of Rich Country Subsidies
<http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20053593~menuPK:34463~pagePK:34370~piPK:34424~theSitePK:4607,00.html>
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