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Serious Prejudice: The Decline and Fall of Agricultural Subsidies After the World Trade Organization's Upland Cotton Decision

Jason G. Buhi*

I. Introduction

A clandestine war is raging. Behind the newspaper headlines, overshadowed by conflicts with Iraqi insurgents, Far-Eastern dictators, and social security reform, America is engaged in another struggle for security. The conflict is real: the victims are civilians; the casualties are jobs. The developing world has declared economic warfare against the United States. In a recent battle, a foreign organization struck a serious blow to heartland America.

In *United States—Subsidies on Upland Cotton*,¹ the full adjudicatory force of the World Trade Organization (hereinafter WTO) was unleashed against agricultural subsidies for the first time. The Republic of Brazil won a WTO Panel decision stating that U.S. government farm support programs compel upland cotton² overproduction, thereby driving down world cotton prices and disrupting market access for Brazilian producers. The U.S. is currently appealing the decision,³ which could result in billion dollar trade sanctions. If extended to other subsidized commodities like wheat, corn and soybeans,

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1. U.S.—Subsidies on Upland Cotton, Aug. 9, 2004, WT/DS267/17 [hereinafter *Cotton*].

2. Upland cotton is a specific genus of cotton, *Gossypium hirsutum*. Hereinafter, it will simply be referred to as “cotton.” For the precise characteristics of upland cotton, see *Cotton*, *supra* note 1, at 7.197.

3. The WTO Appellate Body announced an extended period of review for the *Cotton* decision, predicting a decision for March 2005. Communication from the Appellate Body, WT/DS267/18, Dec. 16, 2004.

or to other heavily subsidized agrarian markets such as the European Union and Japan, *Cotton* could mandate a global shift in agricultural production this decade. The ultimate precedent may guide a generation of policy makers. To ask so much, the WTO should be sure to do so with convincing legal reasoning that minimizes dissent. Indeed, if the WTO is to encroach upon national sovereignty by striking down purely domestic programs, it should do so fairly to protect its moral integrity.

The U.S. appeal affords the WTO Appellate Body an opportunity to quiet critics of the original Panel decision. Although the WTO anticipated this specific conflict for years, the Panel decision does not do justice to the issues presented. If *Cotton* is upheld, challenging nations may not be required to show the amount of economic damage that they allegedly suffer by competing against subsidies. More importantly, the Panel will be permitted to continue dismissing powerful, external influences on the global marketplace in its causation analysis. By eliminating a reasonable calculation of causation and damages, the WTO Panel makes it too easy to prosecute a *prima facie* case, prejudicing the procedure against subsidizing (usually developed) nations. In short, the WTO *Cotton* Panel decision unilaterally convicts the U.S. of causing all of Brazil's perceived woes while mandating compliance with a blank check.

This Comment surveys four issues: 1) the international framework that led to *Cotton*; 2) the legal reasoning of the initial WTO Panel; 3) the U.S. strategy and suggestions for reversal or modifying the holding on appeal; and 4) the ramifications *Cotton* will have if upheld. As the world waits for the appellate decision only one thing is certain: more battles are on the way.

II. Legal Backdrop of *Cotton*

Nations join the WTO to profit from the expansive international market. In exchange for reciprocal trade benefits, WTO Members adhere to agreements meant to lower quotas, subsidies, tariffs and other measures that restrict free trading. For example, the WTO Agreement on Subsidies and Countervailing Measures (hereinafter SCM Agreement or SCM)⁴ outlines a complex plan for Members⁵ to reduce subsidies. Subsidies are direct or indirect payments from a government to any enterprise whose promotion is considered to be in the public interest.⁶ In the global marketplace, subsidies distort trade by artificially lowering

4. Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, WTO Agreement Annex 1A [hereinafter SCM Agreement or SCM].

5. WTO Member nations are referred to as "Members."

6. See SCM Agreement, *supra* note 4 at art. 1, for the technical definition.

market prices or increasing production and market share, giving the subsidizing nation a non-market driven comparative advantage.

Controversial agricultural subsidies were exempted from the SCM Agreement by negotiators and left within the jurisdiction of a separate WTO Agreement on Agriculture (hereinafter Agriculture Agreement).⁷ Article 13 of the Agriculture Agreement,⁸ known as the “Peace Clause,” precluded Members from challenging perceived agricultural subsidies under the SCM Agreement for nine years.⁹ On January 1, 2004 the Peace Clause expired. On that date, Article 21.1 of the Agricultural Agreement¹⁰ was triggered, exposing agricultural subsidies to the general provisions of the SCM Agreement.

If a Member believes that its rights under any agreement are being abridged by the actions of another Member, it may set into motion a dispute resolution procedure.¹¹ The WTO will provide an expert panel to adjudicate the complaint.¹² The parties may appeal a panel decision,¹³ but must conform to the Appellate Body’s prescribed remedy or face WTO authorized sanctions.¹⁴ If necessary, those sanctions are to be commensurate to the damages the aggrieved party suffers.¹⁵

Brazil aggressively pursued the new opportunity, winning a Panel ruling that certain U.S. cotton subsidy programs violate the SCM Agreement.¹⁶ Despite a year of deliberations, the decision is flawed in two respects. The Panel neither required Brazil to quantify the damages suffered, nor considered external variables affecting the global marketplace. In effect, the Panel’s decision unilaterally blames the U.S. for all of Brazil’s perceived woes and mandates U.S. compliance under

7. Agreement on Agriculture, Apr. 14, 1994, [WTO Agreement], Annex 1A [hereinafter Agriculture Agreement].

8. *Id.* at art. XIII. “During the implementation period . . . domestic support measures . . . shall be . . . non-actionable. . . .”

9. *Id.* at art. I(f). Signed in 1995, the exemption of agricultural subsidies from the remedial provisions of the SCM Agreement lasted nine years—until 2004.

10. Agricultural Agreement, art. XXI(1) reads, “The provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement.” The SCM Agreement is an Annex 1A Agreement.

11. Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, [WTO Agreement], Annex 2 [hereinafter DSU].

12. *Id.* at art. 2.

13. *Id.* at art. 17.1.

14. *Id.* at art. 22.

15. *Id.*

16. On May 19, 2003, the WTO Dispute Settlement Body established a Panel in accordance with Article 6 of the DSU. The Panel, composed by the WTO Director-General, consisted of Chairman Mr. Dariusz Rosati and members Mr. Mario Matus and Mr. Daniel Moulis. *Cotton, supra* note 1, at 1.5-8. The Panel made its interim decision on 26 April 26 2004, which was finalized on June 18, 2004.

threat of unspecified sanctions.

III. The Panel Report: *Serious Prejudice* and the Fabric of Our Lives

Brazil alleges that U.S. subsidies cause artificial price suppression in violation of Articles 5 and 6.3 of the SCM Agreement.¹⁷ For a challenging nation to prevail on this claim, a WTO panel must first find that the challenged measures constitute subsidies within the definition of SCM Agreement Articles 1 and 2,¹⁸ and then determine that those subsidies cause “serious prejudice” per SCM Article 6.3. If the panel finds serious prejudice, then SCM Article 5, which forbids Members from causing “adverse effects” to other Members, has been violated.¹⁹ The Article lists four scenarios where serious prejudice may be present including, as Brazil claims here, when a subsidized product causes significant price suppression in the same market for like products.²⁰ The U.S. counters by insisting it does not distort trade because its programs are not directly linked to cotton production. The *Cotton* Panel sided with Brazil, ruling that certain U.S. programs constitute subsidies that cause serious prejudice to the Brazilian cotton industry. Their decision provides a roadmap for challenging agricultural subsidies as SCM Agreement violations.

17. Article 5 of the SCM Agreement lists three ways that an identified subsidy may cause adverse effects that violate the SCM Agreement, including Article 5(c) “serious prejudice to the interests of another Member.” Article 6 elaborates “serious prejudice.”

18. SCM Agreement, *supra* note 4, at arts. 1 and 2.

19. There is an explicit textual linkage between Article 5 and 6.3 of the SCM Agreement. Article 5 states that, “No Member should cause, through the use of any subsidy . . . *adverse effects* to the interests of other Members, i.e.: (c) *serious prejudice* to the interests of another Member.” SCM Agreement, *supra* note 4, at art. 5 (emphasis added). The chapeau of SCM Agreement, Article 6.3 also states that “[s]erious prejudice in the sense of paragraph (c) of Article 5 may arise where one of the following [including the elements in Article 6.3(c)] apply. . . .”

20. SCM Agreement, *supra* note 4, at art. 6.3:

Serious prejudice . . . may arise in any case where one or several of the following apply:

- (a) the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member;
- (b) the effect of the subsidy is to displace or impede the imports of a like product of another Member from a third country market;
- (c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market;
- (d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share that it had during the previous period of three years and this increase follows a particular trend over a period where subsidies have been granted.

A. Identifying the Challenged Measures

Brazil challenged a series of U.S. programs as joint and several violations of the SCM Agreement. The challenged measures include marketing loan payments, user-marketing (“Step-2”) payments, production flexibility contract payments and crop insurance payments.²¹ The specific characteristics of these four programs (discussed below) are important because they will be analyzed twice: once to determine if they fall within the SCM Agreement’s subsidies definition, and again to determine if the subsidies are actionable.

The Agricultural Act of 1949 is the statutory foundation for all of the challenged programs.²² The Act provides the majority of U.S. commodity price and farm income support. The U.S. Congress periodically enacts omnibus farm bills that temporarily change the level and design of the programs.²³ Brazil challenged programs under the two most recent farm bills, the Federal Agricultural Improvement and Reform Act of 1996 (FAIR Act of 1996)²⁴ and the Farm Security and Rural Investment Act of 2002 (FSRI Act of 2002).²⁵

The four different programs are supervised by the Secretary of the U.S. Department of Agriculture (USDA).²⁶ The first of these programs, marketing loans, provide interim financing to prevent producers from defaulting on farm loans.²⁷ Rather than having farmers sell at harvest time when crop prices are lowest, the interim loan enables producers to store their harvested crop, collateral, and repay upon the sale when market conditions are more favorable.²⁸ The repayment due is the lower of the world market price or the loan rate plus interest. If the world market price is lower than the loan rate, the producer repays less than the loan—the difference is a “marketing loan gain.”²⁹ Thus, the marketing loan program compensates producers for the difference between a low world market price for their commodity and a guaranteed target price.

Second, Step-2 payments reward U.S. exporters for buying U.S.

21. *Cotton*, *supra* note 1, at 2.2. The characteristics of these programs will be discussed in detail in this Comment.

22. Agricultural Act of 1949, 7 U.S.C. §§ 1421–1435.

23. *Cotton*, *supra* note 1, at 7.200–201.

24. Federal Agricultural Improvement and Reform Act of 1996 [hereinafter FAIR Act of 1996].

25. Farm Security and Rural Investment Act of 2002 [hereinafter FSRI Act of 2002].

26. *Cotton*, *supra* note 1, at 7.202.

27. Marketing loan payments for cotton began in 1986 and have continued under successive legislation, including the FAIR Act of 1996 and the FSRI Act of 2002. *Id.* at 7.203.

28. *Cotton*, *supra* note 1, at 2.204.

29. *Id.* at 7.207.

cotton rather than cheaper foreign cotton.³⁰ Like the marketing loan payments, fund dispersal is based on the world price of cotton: if the U.S. price exceeds the world price, U.S. businesses are refunded the extra cost of buying the domestic cotton.³¹ The U.S. uses the A-Index, a cotton industry benchmark, to represent the world market price in these loan calculations.³²

Third, production flexibility contract payments (hereinafter PFC payments) distribute money to farmers according to the acres of cotton planted in the past, regardless of what the farmer grows now.³³ Unlike the other three programs, this program was not extended by the FSRI Act of 2002 and ended in September 2002.³⁴ It was intended to support farming certainty and flexibility while ensuring continued compliance with farm conservation and wetland protection requirements.³⁵

Finally, federal crop insurance protects farmers against losses from low crop yields and low market prices.³⁶ The Federal Crop Insurance Act grants the USDA Secretary authority to provide crop insurance, and the Federal Crop Insurance Corporation (FCIC), an agency within the USDA, disperses the funding.³⁷ The producer pays part of the premium while the FCIC pays the balance.³⁸ The FCIC also reinsures the insurance provider, covering most of the underwriting and administrative costs.

Brazil used the preceding information to formulate complex econometric models of the U.S. programs' effects upon the world cotton market. The integrity of these models is vulnerable under the serious prejudice analysis. This analysis determines if and to what extent an identified subsidy is "actionable," i.e., sufficient for WTO remedial action. Before the effect analysis, however, a preliminary inquiry is required to determine if the programs fit the WTO definition of "subsidies."

30. The user marketing (Step-2) program was authorized in 1990 and has been renewed under successive legislation, including the FAIR Act of 1996 and the FSRI Act of 2002. *Id.* at 7.209.

31. *Id.* at 7.210.

32. The "A-Index" is an average of the five lowest price quotes of the principal cottons traded in the world market calculated by Cotlook, a private UK-based organization, available at <http://www.cotlook.com>.

33. *Cotton*, *supra* note 1, at 7.212.

34. *Id.*

35. *See id.* at 7.212-.215.

36. *See id.* at 7.227.

37. *Id.* at 7.203.

38. *Cotton*, *supra* note 1, at 7.227.

B. The Anatomy of a "Specific Subsidy": The Threshold Inquiry for Challenged Measures

The SCM Agreement's definitions and characterizations must be used in any action pursued under the SCM Agreement. Thus, to be actionable a challenged program must be a "subsidy" within the meaning of SCM Article 1,³⁹ and "specific" within SCM Article 2.⁴⁰ The Panel concluded that all four of the U.S. agricultural programs that Brazil challenged satisfied these definitions.

For a challenged measure to be a "subsidy" under SCM Article 1, it must be a "financial contribution" that confers a "benefit."⁴¹ The Panel reasoned that grants made by a government agency constitute *per se* financial contributions, and confer a benefit "by placing the recipient in a better position than the recipient otherwise would have been in the marketplace."⁴² The challenger need not quantify the amount of that financial benefit but merely show it exists⁴³ (while this decision is logical for a preliminary inquiry it is improper when repeated later, during the serious prejudice analysis).

The challenged program must also be "specific" within the meaning of SCM Article 2 to be actionable.⁴⁴ Subsidies statutorily granted to a certain "enterprise," "industry," or group of enterprises or industries, satisfy the specificity criteria.⁴⁵ Brazil observed that none of the challenged measures are widely available throughout the U.S. economy. On the contrary, many of these programs are not even available through

39. Article 1 of the SCM Agreement provides, in part, that:

For the purpose of this Agreement, a subsidy shall be deemed to exist if:

(a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:

(i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees); . . . and

(b) a benefit is thereby conferred.

40. SCM Agreement, Article 2 reads in part:

In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries . . . within the jurisdiction of the granting authority, the following principles shall apply:

(a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific. . . .

41. *Id.*

42. *Cotton*, *supra* note 1, at 7.1116.

43. *Id.* at 7.1119.

44. SCM Agreement, *supra* note 43, art. 2.

45. *Cotton*, *supra* note 1, at 7.1138.

the agricultural sector.⁴⁶ Thus, the programs target only some enterprises. The U.S. did not contest this specificity allegation except as it concerned crop insurance, which the U.S. claims is available to the entire agricultural sector.⁴⁷ The Panel rejected the U.S. stipulation, stating only that “specificity is a general concept and the breadth or narrowness of specificity is not susceptible to rigid quantitative definition.”⁴⁸ This convoluted statement demonstrates the WTO’s willingness to broadly construe the definition of “specific” for the purpose of initiating a subsidy challenge. The Panel concluded that all of the challenged subsidies meet the specificity requirement.⁴⁹

Thus, a challenging nation must satisfy minimal threshold standards to characterize a measure as a subsidy. Whether a subsidy proves to be actionable requires further inquiry. Part III of the SCM Agreement⁵⁰ lays out the standards for identifying and remedying *actionable* subsidies once subsidies have been confirmed.

C. Serious Prejudice and The Panel’s Approach to Significant Price Suppression in the Same Market

Brazil asserts the subsidized U.S. market generates excess cotton which depresses cotton prices in the international market.⁵¹ Brazil has submitted complex econometric models as evidence of the U.S. programs’ effects.⁵² If “significant price suppression,” within the meaning of SCM Article 6.3(c),⁵³ is shown, then SCM Article 5 has been violated.⁵⁴ Violators must remove the adverse effects or face sanctions.

“Price suppression” requires an examination of “price,” so first the market and market price must be identified. The unspecified “market” for the purposes of Article 6.3(c) includes the “world market.”⁵⁵ Brazil chose the A-Index, while the U.S. contended that it merely provides a “price quote.” The Panel provided four reasons the A-Index is a

46. *Id.* at 7.1122.

47. *Id.* at 7.1123.

48. *Id.* at 7.1142.

49. *Id.* at 7.1154-1155.

50. Part III includes Articles 5 (Adverse Effects), 6 (Serious Prejudice) and 7 (Remedies).

51. *Cotton, supra* note 1, at 7.1334.

52. This is to Brazil’s credit, and the veracity of these calculations should be evaluated by the Panel and used to identify an approximate damages that U.S. subsidies cause Brazilian interests. However, the Panel holds the U.S. responsible without identifying such a sum.

53. SCM Agreement, *supra* note 19, at art. 5.

54. SCM Agreement, *supra* note 4, at arts. 1 and 2.

55. *Id.* at 7.1240.

legitimate world market price⁵⁶ including, most importantly, that the U.S. government relies on the A-Index to determine whether its market condition-contingent subsidies (i.e. marketing loan and Step-2 payments) will be paid.⁵⁷

Next, “suppression” exists where prices artificially are prevented from rising, did not rise as much as they should have, or declined.⁵⁸ Here, Brazil alleged cotton prices are prevented from rising. Further, the only prior WTO Panel that examined the meaning of “significant” observed that, “the inclusion of this qualifier in Article 6.3(c) presumably was intended to ensure that margins of undercutting so small that they could not meaningfully affect suppliers . . . are not considered to give rise to serious prejudice.”⁵⁹ The *Cotton* Panel defined the effects of “significant price suppression” as “important, notable or consequential.”⁶⁰ They identified three relevant considerations to this inquiry: (1) the relative magnitude of U.S. production and exports in the world cotton market; (2) general price trends in the market for the subsidized product; and (3) the nature of the challenged subsidies.⁶¹

In the “magnitude” and “general price trend” inquiries the Panel appears to have reduced the separate Article 6.3(d) serious prejudice standard into a factor of the Article 6.3(c) analysis.⁶² Indeed, Brazil brought a separate Article 6.3(d) complaint alleging the U.S. has an unfair share of the world market.⁶³ That complaint failed. The Panel did, however, consider Brazil’s econometric evidence and note the “magnitude” of U.S. exports in their Article 6.3(c) analysis. The Panel noted that the U.S. is the world’s top cotton exporter, and its control of the world market increased from 23.5 percent in 1999 to 40 percent in 2002.⁶⁴ There was a broad decline in overall A-Index cotton price trends

56. *Cotton*, *supra* note 1, at 7.1265-1270.

57. *Id.* at 7.1270.

58. *Id.* at 7.1277.

59. *Cotton*, *supra* note 1, at 7.1321 (referring to Indonesia—Certain Measures Affecting the Automobile Industry, 23 Jul. 1998, WT/DS54/R).

60. *Cotton*, *supra* note 1, at 7.1325.

61. The *Cotton* Panel ruled, “[g]iven the relative magnitude of United States production and exports, the overall price trends we identified in the world market, and the nature of the . . . subsidies in question . . . we are not, by any means looking at an insignificant or unimportant world price phenomenon.” *Id.* at 7.1332.

62. Article 6.3(d) provides a separate actionable subsidy standard, if it can be proven:

(d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share that it had during the previous period of three years and this increase follows a particular trend over a period where subsidies have been granted.

63. *Cotton*, *supra* note 1, at 8.1(ii).

64. *Id.* at 7.1283.

from 1996 through early 2002, indicating that prices may have been artificially depressed since they temporally correlate to the U.S. subsidies and increasing market share.⁶⁵ In 2002 the trend reverses, perhaps indicating the price suppression leveled off or ended.⁶⁶ Yet, the Panel decided that these trends, while factors, are inconclusive for a determination of price suppression.⁶⁷

The Panel's damning consideration regarded the "nature" of the challenged subsidies. They determined that there are two general types of U.S. subsidies: those that are directly price-contingent (i.e., funding is provided in proportion to the current market value of cotton) and those that are not.⁶⁸ Directly price-contingent subsidies, such as marketing loan and Step-2 payments,⁶⁹ are actionable.⁷⁰ If producers repay marketing loans at less than the loan rate, this financial contribution supplements the income of the producer.⁷¹ The greater the difference between the world price of cotton and the marketing loan rate, the greater the subsidy payment will be. Step-2 payments are also price-contingent, basing dispersal upon the relationship between domestic and A-Index world prices.⁷² Thus, these price-contingent programs insulate U.S. production from the effects of the global market.

The Panel found the second group of subsidies, such as PFC payments and Federal Crop Insurance,⁷³ are not price-contingent and therefore not actionable under the SCM Agreement.⁷⁴ By not inducing farmers to produce cotton specifically, these so-called "decoupled" payments do not artificially bloat production or cause significant price suppression. The Panel characterized these programs as mere "income support."⁷⁵ Thus, world price-contingency is the difference between an actionable and non-actionable subsidy.

In short, the Panel decided that two of the four U.S. programs involve SCM Article 6.3 "significant price suppression," causing

65. *Id.* at 7.1351-1352.

66. *Id.* at 7.1288.

67. *Id.*

68. *Id.* at 7.1289.

69. *Id.* at 7.1290.

70. *Id.* at 7.1308.

71. *Id.* at 7.1291.

72. *Id.* at 7.1304.

73. *Id.*

74. *Id.* at 7.1307. The Panel stated:

These subsidies are of a different nature, and thus effect, than the other (price-contingent) subsidies we have examined above. Because they are of a different nature and effect, we decline to aggregate them and their effects with those of the mandatory price-contingent subsidies in our price suppression analysis here. Rather, we must consider them separately.

75. *Id.*

“serious prejudice” to the interests of Brazil and violating the SCM Agreement.⁷⁶ Yet, in making this determination the Panel dismissed several evidentiary submissions the U.S. believes are crucial to a legitimate serious prejudice finding based on econometric models.

D. Causation, Calculations and Controversy

Most controversially, the Panel acknowledged that other factors may have affected prices in the world market over this time period, but dismissed them and effectively decided that a sole causal link exists between the U.S. price-contingent subsidies and the significant price suppression.⁷⁷ The U.S. insists that at the most it is only a partial, not primary factor of Brazil’s woes. The U.S. will resubmit these independent variables and insist that they be weighed appropriately on appeal.

The Panel also decided it is unnecessary to calculate the precise amount of the actionable subsidies in question,⁷⁸ holding that the text of the SCM Agreement contains no quantification requirement. The Panel hedged their conclusion, however, by noting that “a very large amount” of this information is available in the record.⁷⁹ For the U.S. to decide whether to comply with the Panel ruling and drop the subsidies or defy the WTO and face trade sanctions, the U.S. needs to know what the potential sanctions will be. The WTO Panel should provide the U.S. at least an approximate figure.

Brazil is not to blame for this failure to communicate. Brazil provided complex econometric calculations utilizing USDA information, calculating a total of \$12.9 billion of U.S. agricultural subsidies from 1999-2002.⁸⁰ The Agriculture Agreement caps WTO Members’ annual legal subsidy ceilings at 1992 levels:⁸¹ approximately \$1.6 billion dollars for U.S. cotton.⁸² Brazil estimates that without the excess subsidies U.S. cotton production would have fallen 29 percent, while exports would have decreased 41 percent.⁸³ Brazil projects these events would have led to a 12.6 percent rise in international cotton prices,⁸⁴ benefiting their

76. *Cotton*, *supra* note 1, at 7.1395.

77. *Id.* at 7.1355-1361.

78. *Id.* at 7.1297, 7.1349.

79. *Id.* at 7.1349.

80. *Id.* at 7.1335.

81. Agriculture Agreement, art. 13(b)(ii). This amount is permitted beyond the Peace period, notwithstanding the SCM Agreement.

82. Carmen Gentile, *Analysis: Brazil Wins Round One on Cotton*, WASH. TIMES, Apr. 28, 2004, available at <http://www.washtimes.com/upi-breaking/20040428-043535-4238r.htm> (last visited June 7, 2005).

83. *See id.*

84. *Id.*

producers. More specifically, Brazil estimates that \$600 million in sales were lost during the 2001 marketing season alone.⁸⁵ This is exactly the approximate type of sum figure that the WTO Panel should publish in the interest of fairness.⁸⁶

Without a fair calculation of the direct effect of U.S. subsidies, the U.S. could be held responsible for more than its fair share of the perceived harm to Brazilian merchants. Furthermore, without publishing this figure, the U.S. will not be able to rationally develop its political response. The U.S. is currently appealing the Panel decision. The U.S.'s econometric models will be the basis of the American appeal.

IV. The United States' *Cotton* Appeal

Shortly after the *Cotton* decision, U.S. Trade Representative⁸⁷ (USTR) Robert B. Zoellick⁸⁸ characterized the Panel's verdict as "mixed" and expressed optimism about the appeal.⁸⁹ He commended certain aspects of the decision: that no causal link exists with respect to the non-world price contingent subsidies (i.e., PFC payments and crop insurance) and that the Panel refused to find that U.S. subsidies caused "future serious prejudice" to Brazil's interests from 2003-2007, even though several programs have been authorized through 2007 by the FSRI Act of 2002.⁹⁰ Clearly the decision assumes that the U.S. will comply and remove the subsidies. On October 18, 2004, the U.S. delegation alerted the WTO Membership of their official decision to appeal.⁹¹ The U.S. will provide the WTO Appellate Body with information in an attempt to reverse, change, or modify *Cotton* in some way.

While WTO dispute settlement proceedings are confidential,⁹² the U.S. publicized the statistical evidence it will use to appeal the WTO

85. Andrew Hay, *Brazil Wins WTO Cotton Ruling*, Swissinfo, Apr. 27, 2004, available at <http://www.swissinfo.org/sen/Swissinfo.html?siteSect=1438sid=4896435> (last visited May 30, 2005).

86. Of course, the Panel should also weigh the \$600 million dollar figure against the factors external to the U.S. subsidies.

87. The USTR is part of the Executive Office of the President and advises the President on trade policy. The U.S. Trade Act of 1974 grants the President (and therefore, the USTR) broad discretion in formulating trade policy.

88. Robert Zoellick was appointed Deputy Secretary of State under Condoleezza Rice on January 7, 2005. His successor at the USTR, Ambassador Rob Portman, was sworn in on April 29, 2005.

89. See *WTO Panel Issues Mixed Verdict in Cotton Case*, Office of the United States Trade Representative, Sept. 8, 2004, available at http://www.ustr.gov/Document_Library/Press_Releases/2004/September/WTO_Panel_Issues_Mixed_Verdict_in_Cotton_Case.html (last visited May 30, 2005).

90. *Cotton*, *supra* note 1, at 7.1501-03.

91. Appeal is a right pursuant to Article 16 of the DSU. DSU, *supra* note 11, at art. 16.

92. DSU, *supra* note 11, at art. 14.

Panel decision.⁹³ For example, the U.S. will challenge the findings that it is guilty of significant price suppression and that a challenger need not demonstrate the amount of damages from the challenged subsidies.⁹⁴ The U.S. will employ several independent econometric models to show other factors contributed to the lost market access suffered by Brazil.⁹⁵ Additionally, the U.S. will present a defense based on the textual interpretation of the SCM Agreement.

A. *Independent Studies*

The U.S. will challenge the Panel decision that Brazil need not demonstrate the amount of the challenged subsidies and attack Brazil's econometric models. Hoping the Appellate Body will decide that such calculations are essential to the serious prejudice inquiry, the U.S. will present independent calculations showing Brazil's numbers are exaggerated. Brazil asserted that world cotton prices would have risen 12.6 percent in lieu of American subsidies from 1999-2002.⁹⁶ Three recent independent studies from varied sources indicate otherwise. First, Texas Tech University's econometric models concluded that removal of the U.S. programs would result in a world price decrease of less than 1 percent.⁹⁷ Second, the United Nations Food and Agricultural Organization estimated that removal of all cotton subsidies worldwide, including high subsidies in the E.U. and Japan, would result in just a 3.1 percent increase in world cotton prices.⁹⁸ Third, a 2003 IMF study⁹⁹ concluded that elimination of U.S. programs would only result in a 2 percent change in world cotton prices.¹⁰⁰ How these studies are weighted against Brazil's models by the Appellate Body may make or break the U.S. presentation.

93. See *Dispelling Myths About U.S. Support to Cotton Farmers: U.S. Programs Have Not Caused Low Cotton Prices and Hurt Foreign Growers*, USTR, Sept. 8, 2004, available at http://www.ustr.gov/assets/Document_Library/Fact_Sheets/2004/asset_upload_file784_6153.pdf (last visited June 7, 2005)[hereinafter USTR].

94. Notification of Appeal by the United States, WTO/DS267/17, Oct. 20, 2004.

95. *Cotton*, *supra* note 1, at 7.1355.

96. *Id.* at 7.1355.

97. World Cotton Model by the Cotton Economics Research Institute (CERI) at Texas Tech University, available at <http://www.ceri.ttu.edu/policy/publications/presentations/new%20report.pdf> (last visited May 30, 2005).

98. In the FAO model, the U.S. programs accounted for two-thirds of the payment modeled, and would therefore alone result in only a two percent difference on world cotton prices. USTR, *supra* note 98, at 3.

99. International Monetary Fund.

100. USTR, *supra* note 98, at 3.

B. *Mitigating Evidence*

The initial Panel rejected arguments that other factors were responsible for Brazil's perceived woes.¹⁰¹ The U.S. hopes the legal conclusion that it causes serious prejudice will be overturned or mitigated. The U.S. will re-offer these arguments, among others,¹⁰² in an attempt to prove to the Appellate Body that U.S. subsidies are only a partial, not primary, factor for any harm suffered by Brazil.

First, the U.S. asserts that the disposition of U.S. cotton production has shifted from domestic mills to export markets in recent years, placing more U.S. cotton on the export market.¹⁰³ This is because the U.S. percentage of world consumption declined between 2001 and 2004, allowing U.S. exports to increase while U.S. production remained stable, hovering around 20 percent of the world supply between 1999-2001.¹⁰⁴ The U.S. also posits that demand for new, competing low-priced synthetic fibers may also account for increased U.S. exports.¹⁰⁵

Second, the U.S. asserts its programs have not insulated domestic farmers from market forces, because U.S. cotton acreage increases and decreases in proportion to the rest of the world. According to the USTR statistics, U.S. producers plant cotton commensurately with producers in the rest of the world.¹⁰⁶ In marketing year 2002-2003, U.S. farmers actually decreased their acreage while foreign production increased.¹⁰⁷ The U.S. insists this would not have been possible if the U.S. were insulated from world price movements.

Third, the U.S. asserts that world consumption fluctuated when China released millions of bales of government cotton supplies between 1999 and 2001.¹⁰⁸ China is the largest producer and user of raw cotton in the world,¹⁰⁹ and USTR statistics show an undeniable correlation

101. *Cotton*, *supra* note 1, at 7.1355-1361.

102. A National Cotton Council (NCC) representative stated that:
a more decoupled U.S. cotton program, a lower loan rate, a lower target price, a stable world market share, an unbiased economic study showing minimal price impacts and Brazil's own dramatic increase in cotton production all point to a U.S. cotton program that is not causing serious prejudice to Brazil, or any other country in the world.

NCC Disagrees With Brazil/U.S. Dispute Panel's Decision, available at <http://www.cotton.org/news/releases/2004/brazil-public.cfm> (last visited June 7, 2005).

103. *Cotton*, *supra* note 1, at 7.1361.

104. USTR, *supra* note 98, at 4.

105. *Cotton*, *supra* note 1, at 7.1358. USTR, *supra* note 98. The U.S. is relying on the Texas Tech University study for these figures, *supra* note 95.

106. USTR, *supra* note 98, at 6-7.

107. *Id.*

108. *Cotton*, *supra* note 1, at 7.1361. USTR, *supra* note 98, at 3.

109. *Id.*

between Chinese net cotton imports and the A-Index.¹¹⁰ For the past fourteen years the world price of cotton has paralleled the metric tonnage imported by China.¹¹¹ Generally, when China increases imports or decreases exports, cotton prices go up; conversely, when China decreases imports or increases exports, cotton prices fall.¹¹² From 1999-2001, China exported cotton. The original Panel rejected this contention because the Chinese exports were “smaller in magnitude” than the U.S. exports over the same period.¹¹³

If the Appellate Body affirms that Brazil is suffering serious prejudice, the U.S. hopes this evidence will help attenuate Brazil’s plight from the U.S. subsidies.

C. The Discretionary Interpretation of Serious Prejudice

The U.S. will also present a textual defense. Even if the U.S. is committing serious prejudice the finding alone may not be enough to hold the U.S. financially responsible. The use of “may” in the introductory sentence of Article 6.3 of the SCM Agreement indicates that serious prejudice may not exist even if the circumstances listed in Article 6.3 are found.¹¹⁴ The “may” in SCM Article 6.3 contrasts with the “shall” in SCM Article 6.1.¹¹⁵ Statutory drafters show their intent by using language consistently within a document. Thus, the drafters intended the Panel to have broad discretion in determining serious prejudice by using “may.” However, the Panel rejected this argument, noting that there are no additional criteria found in Article 5 or 6 of the SCM Agreement.¹¹⁶ The Panel once again hedged its opinion by saying, “In any event, even assuming *arguendo* that any sort of additional demonstration is necessary . . . we believe that Brazil has also fulfilled that burden.”¹¹⁷ In conjunction with the mitigating factors and independent studies discussed before, the U.S. may be able to demonstrate that the burden of proof needed by Brazil to prevail has not been met. Thus, even though serious prejudice may be present, causation is unclear.

110. USTR, *supra* note 98, at 3.

111. A-Index Northern Europe, available at http://www.cotlook.com/information/cotlook_indices.php (last visited May 30, 2005).

112. USTR, *supra* note 98, at 4.

113. *Cotton*, *supra* note 1, at 7.1361.

114. *Cotton*, *supra* note 1, at 1377.

115. SCM Agreement, *supra* note 4. Article 6.1 reads, “Serious prejudice in the sense of paragraph (c) of Article 5 shall be deemed to exist in the case of . . .” (emphasis added).

116. *Cotton*, *supra* note 1, at 7.1372.

117. *Cotton*, *supra* note 1, at 7.1391.

V. Potential Policy Ramifications of the *Cotton* Decision

“This is a precedent; this is a war that must continue,” a Brazilian lawyer cheered after learning of the *Cotton* decision.¹¹⁸ Meanwhile, White House spokesman Scott McClellan said, “[w]e will be defending U.S. agricultural interests in every form we need to, and have no intention of unilaterally taking steps to disarm when it comes to this.”¹¹⁹ Despite the rhetoric, the U.S. may compound the *Cotton* fallout if they chose defiance. President Bush recently chose to remove steel subsidies to avoid suffering more severe trade penalties.¹²⁰

The WTO Appellate Body may uphold, modify, or reverse the legal findings and conclusions of the Panel.¹²¹ If the Appellate Body reverses the Panel decision, the American agricultural programs will continue unabated. If *Cotton* is upheld, the implications for the U.S., E.U., Japan and other agricultural subsidizers will be significant. Although some modification is likely due to the sheer size of the Panel decision,¹²² some of the following scenarios might play out:

1) The United States can comply. American farmers benefit from \$19 billion dollars in annual subsidies.¹²³ Weaning them off may shut down many farms, especially smaller ones. Less federal support would also likely reduce the acreage that remaining U.S. farmers plant. Some cotton acreage may shift to other crops such as corn or soybeans, but in some areas there is no alternative to planting cotton.¹²⁴ Furthermore, the clear danger is that other U.S. crop programs may be challenged, including those for wheat, rice, feed grains, and soybeans. Following *Cotton*, each of these commodity sectors (which are subsidized under the same legislation as cotton), will tumble like dominoes. American farmers rightly fear for their livelihood. On the other hand, some free trade economists argue that subsidies are never in the best interests of America and that the WTO is providing the U.S. an opportunity to remove this sector from the government dole.¹²⁵

118. Elizabeth Becker, *WTO Rules Against U.S. on Cotton Subsidies*, N.Y. TIMES, Apr. 27, 2004, late ed., at A1 [hereinafter Becker].

119. Jeffrey Sparshott, *U.S. Shies From WTO Cotton Ruling*, WASH. TIMES, Apr. 28, 2004, available at <http://www.washtimes.com/business/20040427-092747-2629r.htm> (last visited May 30, 2005) [hereinafter Sparshott].

120. Becker, *supra* note 118.

121. DSU, *supra* note 11, at art. 17.13.

122. The *Cotton* Panel decision is 351 pages long. See *Cotton*, *supra* note 1.

123. Becker, *supra* note 118.

124. Harry Baumes, *Implications of WTO Ruling on U.S. Cotton Subsidies*, Global Insight, available at <http://www.globalinsight.com/Perspective/PerspectiveDetail928.htm> (last visited May 30, 2005).

125. See generally ECONOMIST. See also John Baffes, *The “Cotton Problem,”* available at http://www.fao.org/es/esc/common/ecg/47647_en_CottonProblem_

2) The U.S. may refuse to comply. This would cause the WTO to authorize Brazil to deny the U.S. equivalent trade access,¹²⁶ making the lack of a calculation of damages significant. Policy makers cannot make an informed decision when they lack key facts, i.e., the amount of trade sanctions they risk. Further, although Brazil's sanctions for cotton subsidies may not be large vis-à-vis American interests, it could easily be compounded. Other nations with cotton economies will challenge the U.S. to claim their "piece of the action." If Brazil wins the precedent and cotton statistics will be readily available,¹²⁷ other commodity sectors will be challenged. Thus, American farmers rightly fear being squeezed out of the market by the low cost of labor in developing countries. Agriculture is a powerful interest group in the U.S., and it will surely invest political capital in representatives who protect their jobs, no matter the cost.¹²⁸

3) In either event, the U.S. can retaliate. The U.S. has powerful weapons of economic warfare immediately at its disposal. For example, the U.S. grants a Generalized System of Preferences, or "GSP" privileges, to many developing nations. It can deny these privileges to Brazil or other challengers for a variety of reasons.¹²⁹ Although Brazil is eligible for GSP benefits,¹³⁰ it is also on the USTR's 2004 Special 301 Watch List for being a leading worldwide violator of intellectual property rights.¹³¹ As the U.S. economy shifts from exporting agriculture

Baffes.pdf (last visited May 30, 2005).

126. The amount is probably in the range of \$600 million dollars annually, per the Brazilian estimate of lost sales.

127. *Cotton, supra* note 1, at 7.1396. Brazil asserted that other WTO Members, in particular African cotton-producers, suffer serious prejudice as a result of the U.S. subsidies. The text of Article 7.2 of the SCM Agreement makes it clear that the remedies available in Article 7 of the SCM Agreement may only be invoked by a Member itself. Thus, the WTO Panel only considers serious prejudice experienced by the complaining Member.

128. The National Cotton Council (NCC) is the central organization of the U.S. cotton industry and a strong advocate of the U.S. appeal. Its members include producers, ginner, oilseed crushers, merchants, cooperatives, warehousemen, and textile manufacturers. NCC representatives often testify before Congress. *See, e.g.,* <http://www.cotton.org/gov/testimony/trade-testimony.cfm> (last visited May 30, 2005).

129. The GSP promotes exports of manufactured goods from developing countries to help free the countries from heavy dependence on trade. Through a series of unilateral duty-free trade preferences, developed countries lower the duties they assess on goods imported from developing countries, helping the latter mitigate the high cost of investment in new industries. Each developed nation is free to determine the nature and scope of the concessions it grants. In the U.S., broad discretionary authority is granted to the President under the U.S. Trade Act of 1974.

130. U.S. Generalized System of Preferences Guidebook, 19, *available at* http://www.ustr.gov/assets/Trade_Development/reference_Programs/GSP/asset_upload_file333_5430.pdf (last visited May 30, 2005).

131. USTR, *2004 Special 301 Report Executive Summary, available at* http://www.ustr.gov/assets/Document_Library/Reports_Publications/2004/2004_Special_

and manufactured products to exporting culture and technology, intellectual property is the key U.S. sector for economic growth and must be respected. If it chooses this course of action, the U.S. should differentiate between the intellectual property and the agricultural issues. If it appears that Brazil is being denied benefits in response to *Cotton*, it may incite anti-Americanism within the WTO and trade circles. Policy makers should appear to act in good faith because a more conciliatory tone will be prudent in the long run. On the other hand, the U.S. should not reward those who attack its interests and there are separate, independent grounds to deny Brazil GSP privileges.

4) Finally, the U.S. can seek a separate peace through bilateral or multilateral negotiations. A compromise through trade talks could be much less painful for the U.S. than either strict compliance or defiance. Agriculture is a major topic at the current Doha Round of trade negotiations,¹³² which will set trade policy for a generation. The U.S. is standing shoulder to shoulder with the E.U. and Japan on this issue. Each provides extensive agricultural support. U.S. trade negotiators have asked developing nations, including Brazil, to open their markets to more U.S. industrial products in return for lower agricultural subsidies,¹³³ better market access, and help in meeting international production standards.¹³⁴ *Cotton* makes the U.S. bargaining position weaker. Developing nations emboldened by this ruling will demand more for permitting U.S. subsidies to continue and offer fewer concessions. The trickle-down effect could sidetrack plans for a hemispheric free trade bloc and other initiatives.¹³⁵ The U.S. has recently entered into a Central American Free Trade Agreement (CAFTA),¹³⁶ a free trade agreement

301/asset_upload_file16_5995.pdf (last visited Jan. 15, 2005). "Special 301" requires the USTR to identify countries that deny effective protection for U.S. intellectual property rights. Countries that offer the least protection for relevant U.S. products are designated "Priority Foreign Countries" and risk trade sanctions. Other lists do not incur immediate sanctions, including the "Priority Watch" and "Watch List."

132. The conference in Doha, Qatar, provides the mandate for negotiations on a range of subjects and other work involving all aspects of the WTO's jurisdiction. Brazil is aware of its new leverage in the Doha Round negotiations. See Clóvis Rossi, *Brasil Tem Vitória na OMC Contra os EUA*, available at <http://www1.folha.uol.com.br/folha/dinheiro/ult91u83494.shtml> (last visited May 30, 2005).

133. *Delivering on Doha's Promise: 2005 Will Be a Vital Year for Free-Trade Talks*, *ECONOMIST*, Jan. 6, 2005.

134. Sparshott, *supra* note 118.

135. Co-chaired by Brazil, the proposed 34-nation Free Trade Area of the Americas would lower trade barriers for every nation in the Western Hemisphere except Cuba.

136. *Free Trade with Central America: Summary of the U.S.-Central America Free Trade Agreement*, Dec. 17, 2003, available at http://www.ustr.gov/Document_Library/Fact_Sheets/2003/Free_Trade_with_Central_America_Summary_of_the_U.S.-Central_America_Free_Trade_Agreement.html (last visited June 7, 2005).

with Chile,¹³⁷ and is aggressively pursuing talks with other Andean nations. Thus, nearly all U.S. trade relations will be affected by the ultimate *Cotton* decision.

VI. Conclusion

U.S. Senator Kent Conrad lamented that *Cotton* “has potential to have extraordinary consequences up and down every main street in rural America.”¹³⁸ As it stands, the evidence needed to condemn a subsidizing nation is minimal and circumstantial. *Cotton* ignores externalities affecting the global marketplace and avoids a calculation of damages.

If, as likely, the overall decision is upheld and the U.S. programs fall, the WTO needs to strengthen its legal reasoning. By demanding a more complete evidentiary calculation, the WTO can ensure that a single nation does not shoulder responsibility for every anomaly in the complex international marketplace. Informing the subsidizer of this approximation will also enable the nation to rationally consider its options. Further, the WTO should take great care to resolve this crisis amiably so as to not distort its present and future role on the world stage. The standards that emerge from the *Cotton* Appeal may dictate the future of international agriculture, the WTO, and international trade for generations to come.¹³⁹

137. *Free Trade With Chile: Summary of the U.S.-Chile Free Trade Agreement*, available at http://www.ustr.gov/Document_Library/Fact_Sheets/2002/Free_Trade_with_Chile_Summary_of_the_U.S._Chile_Free_Trade_Agreement.html (last visited June 7, 2005).

138. Elizabeth Becker, *Lawmakers Voice Doom and Gloom on WTO Ruling*, N.Y. TIMES, Apr. 28, 2004, at C1.

139. The WTO Appellate Body has considered the issue longer than expected and predicts its ultimate decision will be made in 2005. *United States—Subsidies on Upland Cotton. Communication from the Appellate Body*, Dec. 12, 2004, available at <http://www.docsonline.wto.org>.

