Agricultural Situation Spotlight

# How the Brazil-U.S. Cotton Dispute Could Affect Iowa's Agriculture

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Recently, a World Trade Organization (WTO) panel ruled on a dispute between Brazil and the United States. The dispute, filed by Brazil over cotton subsidies, accused the United States of lowering world agricultural prices and distorting agricultural trade flows through various forms of agricultural support. Preliminary findings, as reported by major news sources such as CNN, the *New York Times*, and the *Economist* magazine, indicate that the WTO panel agreed with most of Brazil's case. The results of these findings and the ongoing WTO agricultural trade negotiations could have a dramatic impact on the ways agriculture can be supported by the federal (and state) government. And these possible changes in support could affect production agriculture in Iowa.

## Brazil's Dispute on U.S. Cotton Support

While the WTO dispute has several components, the essence of Brazil's claim is that the United States violated WTO commitments by providing support through various trade-distorting programs in an amount that exceeded allowable levels. The types of support challenged include cotton-specific programs, such as the Step 2 program, and more general programs, such as the marketing loan and direct payments programs. The reports suggest that the WTO panel found fault with both the cotton-specific and the general programs.

The WTO panel's report is not widely available as of this writing but is expected to be released to the general public sometime this summer. Therefore, comments in this article are based on published reports from news agencies covering the dispute. If the WTO panel ruled that the general programs had distorted world production and trade in cotton, then changes may be required in these programs to limit these distortions and bring U.S. agricultural policy back in line with our WTO agricultural commitments. The general programs (direct payments, countercyclical payments, marketing loans, and crop insurance) make up the vast majority of U.S. agricultural support that flows directly to producers. These programs are in effect for several crops, not just for cotton. Thus, if the cotton dispute ruling stands, changes in these programs for all program crops may be warranted.

WTO trade disputes are like court cases in that the parties may appeal decisions handed down by dispute panels. The United States will most certainly appeal this ruling and attempt to overturn the decision. However, if the decision stands, then policymakers will need to adjust U.S. support programs to comply with the WTO or face penalties for not doing so. Exactly what adjustments would have to be made depends on the exact nature of the findings of the WTO panel. A reasonable guess, however, would be removal of any production and trade incentives from these programs, and this would likely be accompanied by smaller payments.

The cotton dispute arose from the large flow of funds going to U.S. agriculture in the late 1990s and early 2000s. Direct payments, called AMTA (Agricultural Market Transition Assistance) or "Freedom to Farm" payments, were paid out on an annual basis. Congress provided Market Loss Assistance payments to offset low commodity prices. Marketing loan benefits, through loan deficiency payments, increased dramatically over the period. Crop insurance premium

**Table 1. Government support (billion $)**

| | | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| Corn | Direct Payments | 2.5 | 2.4 | 1.9 | 1.8 |
| | Countercyclical Payments | 0.0 | 0.0 | 0.0 | 0.0 |
| | Market Loss Assistance Payments | 2.5 | 2.5 | 2.2 | 0.0 |
| | Marketing Loan Benefits | 2.4 | 2.6 | 1.2 | 0.0 |
| | Crop Insurance Benefits | 0.1 | 0.0 | 0.2 | 0.9 |
| Soybeans | Direct Payments | 0.0 | 0.0 | 0.0 | 0.0 |
| | Countercyclical Payments | 0.0 | 0.0 | 0.0 | 0.0 |
| | Oilseed Payments | 0.0 | 1.3 | 0.0 | 0.0 |
| | Marketing Loan Benefits | 2.3 | 2.6 | 3.4 | 0.0 |
| | Crop Insurance Benefits | 0.1 | 0.2 | 0.1 | 0.3 |
| Upland Cotton | Direct Payments | 0.6 | 0.6 | 0.5 | 0.5 |
| | Countercyclical Payments | 0.0 | 0.0 | 0.0 | 1.3 |
| | Market Loss Assistance Payments | 0.6 | 0.6 | 0.5 | 0.0 |
| | Marketing Loan Benefits | 1.5 | 0.5 | 2.5 | 0.8 |
| | Step 2 Benefits | 0.3 | 0.4 | 0.3 | 0.2 |
| | Crop Insurance Benefits | 0.3 | 0.4 | 0.5 | 0.3 |

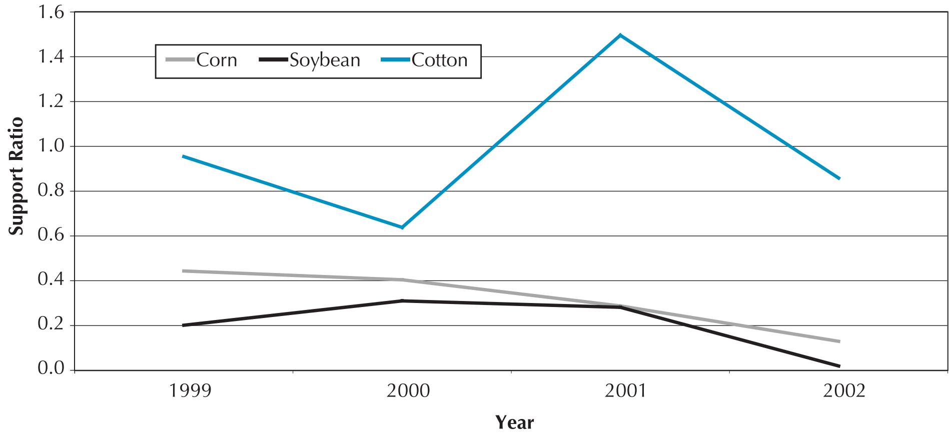


**Figure 1. Ratio of government support versus value of production**

subsidies were increased to induce participation. Between August 1999 and July 2003, roughly $12.5 billion in support was provided to the U.S. cotton industry. That works out to just over $3 billion in annual support. From 1999 to 2003, the annual total value of U.S. cotton production ranged from $2.8 to $5.3 billion. Table 1 shows the types and amounts of support going to cotton, corn, and soybeans for the 1999-2002 crop years. Figure 1 shows the ratios of the sum of this government support versus the value of production. As can be seen in Figure 1, the level of agricultural support was sizable in comparison to the value of production. This information, in combination with the market share of U.S. cotton exports in the world market, led Brazil to argue that these payments provided an additional incentive to produce (over and above the incentive from market prices alone) and that the resulting increase in production drove down world prices and blocked those cotton producers who farmed without subsidization from trading opportunities.

## Corn and Soybean Programs Next?

The WTO decision relates to Iowa agriculture because Iowa's major crops—corn and soybeans—have many of the same programs providing support. Also, the United States is a major exporter in these crops, as it is in cotton. So, parallel arguments could be made about the effects of government support on the production and trade of corn and soybeans. While the scale of government support for corn and soybeans is smaller (as measured by the ratio of support to production value), the overall amount of expenditures is larger for both corn and soybeans. In Iowa alone, direct payments for corn and soybeans amount to over $500 million annually. Countercyclical payments could range from $0 to over $700 million annually. Most of Iowa's corn and soybean production is covered by crop insurance and/or is enrolled in the marketing loan program. Thus, any changes in these programs could have significant effects on the amount of agricultural support flowing to Iowa. Reports also suggest that export credit guarantee programs for several commodities, including cotton, corn, and soybeans, were investigated by the WTO dispute panel and found to be noncompliant. If the ruling holds, these guarantee programs would need to be eliminated.

Whether similar disputes against corn and/or soybeans would be successful would depend on the WTO dispute panel and the evidence brought forward by the parties in the dispute. But a study conducted by the Food and Agricultural Policy Research Institute in 2002 indicates that claims against U.S. corn and soybean programs would be more difficult to prove. The study looked at the production, price, and trade effects of the full liberalization of agriculture, that is, the removal of all agricultural trade barriers and support programs. If we examine the results for 2004 in comparison with the FAPRI baseline used in the analysis, world prices would be higher for all three crops under full agricultural liberalization. Cotton prices would be 18 percent above the level they would be if no liberalization occurred. Corn and soybean prices would rise by 5 and 4 percent, respectively. In two of the three commodities, U.S. production would fall. The analysis finds that corn production would increase with liberalization. The impact on cotton is again at least twice what it is on corn and soybeans.

Part of Brazil's case on cotton was that the subsidies drove U.S. production up and world prices down. The numbers in Table 2 attest to how such an argument could be made. World (not just U.S.) interference in these agricultural markets has significant effects. Cases against corn and soybeans would be tougher to argue, as the estimated impacts are one-third to one-half as large as they are for cotton. ◆

**Table 2. World price and U.S. production impacts of agricultural liberalization**

| Crop | World Price Change (percent) | U.S. Production Change (percent) |
|---|---|---|
| Cotton | +18 | –11 |
| Corn | +5 | +4 |
| Soybeans | +4 | –3 |