

## The C4 should revise its argumentation to save African cotton producers at the WTO

### Comments on the C4' communication to the WTO on 1<sup>st</sup> March 2006

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### **1) The core of the C4's proposals**

On February 16, 2006 the 4 West African countries co-Sponsors of the Sectoral Initiative in favour of cotton at the WTO, so-called 'C4', have proposed to the WTO's Sub-Committee on cotton that "*The level of reduction of domestic support for cotton shall be three times higher than that of the reductions to be made under whatever general formula is agreed for the reduction of domestic support in agriculture*" and that "*The time period for the reduction of domestic support for cotton shall be one third of the period agreed upon for the reduction of domestic support in agriculture in general*". The 1<sup>st</sup> March they have specified the higher percentages of reduction of the overall domestic trade distorting supports (OTDS) – which groups together the total AMS, *de minimis* supports and the blue box – which would apply to cotton according to the reduction rates to which the different countries will be submitted, for instance:

General reduction rate	Cotton reduction rate	Rates gap
60%	82.2%	22.2%
70%	84.3%	14.3%
80%	88.3%	8.3%
90%	93.7%	3.7%
100%	100%	0

### **2) The C4 is confusing the *allowed* and *applied* levels of domestic support**

#### **a) The C4 proposal is facing an enormous legal ambiguity**

There is no doubt that, in the minds of C4 and of many WTO Members, the reduction of domestic supports on cotton they are concerned with is about the actual supports, which is not contradicted by paragraph 11 of the Hong Kong Declaration: "*Members agree that the objective is that, as an outcome for the negotiations, trade distorting domestic subsidies for cotton production be reduced more ambitiously than under whatever general formula is agreed and that it should be implemented over a shorter period of time than generally applicable*". However paragraph 4 of the Declaration specifies that it is working within the mandate of the Framework Agreement of August 1<sup>st</sup> 2004: "*We reaffirm our commitment to the mandate on agriculture as set out in paragraph 13 of the Doha Ministerial Declaration and to the Framework adopted by the General Council on 1 August 2004*".

Then paragraph 6 of the Framework Agreement states without ambiguity that the reduction of the OTDS concerns the *allowed* support levels and not the *applied* support levels: "*Each such Member will make a substantial reduction in the overall level of its trade-distorting support from bound levels. As well as this overall commitment, Final Bound Total AMS and permitted *de minimis* levels will be subject to substantial reductions and, in the case of the Blue Box, will be capped*". Since the general formula is about the reduction of the *allowed* (or *permitted*) support levels, the same provision applies to the reduction of cotton support. However, in the Agreement on Agriculture (AoA) on the basis of which the Framework Agreement has been devised, there is no *allowed* product-specific support, therefore not more for cotton.

We have therefore to distinguish the *allowed* or *bound* total AMS from the *applied* or *used* or *notified* total AMS. Let us take the cases of the EU and USA.

#### **b) The EU case**

For the EU the *allowed* total AMS is of €67.2 billion since July 2001 whereas its *applied* total AMS has been reduced to €39.3 billion in 2001-02 (the last notified marketing year) and, following the CAP reform started in June 2003, should be of about €18.8 billion the 1<sup>st</sup> January 2008, when the implementation of the Doha Round would start. This would reduce by €48.4 billion the *applied* total AMS in relation to the *allowed* total AMS of €67.2 billion, a 72% drop, which explains why Peter Mandelson has proposed to reduce it by 70% without having actually to reduce anything of the *applied* total AMS which could even increase by €1.6 billion!

All the same the EU *allowed* total product-specific and non product-specific *de minimis* supports were of €19 billion for 2001-02 whereas the *applied* (and *notified*) total *de minimis* supports were only of €1 billion. Hence we can understand the EU proposal of 28 October 2005 that developed countries reduce their *de minimis* support by 80% since it could reduce it by 94.5%! As for the blue box, the EU has notified it at €23.7 billion in 2001-02 but, since the CAP (Common agricultural policy) reform of 2003-04 has transferred 90% of it in the 'single farm payment' (SFP) alleged to be in the green box, the residual blue box would not exceed €7 billion the 1<sup>st</sup> January 2008 when the Doha Round implementation would start.

Actually the available reduction of the EU applied OTDS are practically nil if we take into account the massive cheatings in its notifications and the non compliance of the present CAP with the AoA rules<sup>1</sup>.

#### **c) The US case**

All the same the US *allowed* or *bound* total AMS has been of \$19.1 billion since the end of 2000 whereas its applied or notified total AMS was at 14,4 milliards at the end of 2001. Contrary to the EU however, reducing by 53% the allowed OTDS would imply a drop of \$7.9 billion in relation to the applied level in the 1999-01 base period proposed by the USA. And this without even taking into account the massive cheatings in its notifications and the non compliance of the present Farm Bill with the AoA rules. As the EU, the USA has cheated massively in its subsidies to feedstuffs, irrigation, agricultural credit and tax rebates on agricultural fuel. The production flexibility contracts payments, the fixed direct payments and the counter-cyclical payments (CCP) should have been (or should be for the CCP) notified in the amber box. The *allowed* non product specific *de minimis* support will have disappeared so that its subsidies would be added to the total AMS and the *allowed* product-specific *de minimis* would have collapsed following the attribution of product-specific AMSs to meats (bovine meat, mutton, pork and poultry meat) as a result of taking into account feedstuffs subsidies<sup>2</sup>.

#### **d) The capping of product-specific AMSs**

The only provision of the Framework Agreement on the *applied* domestic supports, confirmed by the Hong Kong Declaration, relates to the product-specific AMSs – therefore also that of cotton – which will have to be capped at the level of a base period to be decided, but there is no obligation to reduce them as long as the *allowed* total AMS will be higher and the reduction could then be ascribed to other products than cotton provided the *applied* total AMS stay within the limits of the *allowed* total AMS. And the same works for the reduction of the other two components of the allowed OTDS (*de minimis* and blue box) which is not obliged to bear on a specific product.

What Members did not realize is that capping the product-specific AMSs at their level of a base period to be decided ends up in bounding a new "base total AMS" as long as the non product-specific AMS is nil and excluded from the total AMS as a result of the *de minimis* exemption. If this fact

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<sup>1</sup> Jacques Berthelot, *The empty promise and perilous game of the European Commission to slash its agricultural supports*, 3 November 2005.

<sup>2</sup> Jacques Berthelot, *The king is naked: the impossible U.S. promise to slash its agricultural supports*, Solidarité, 7 November 2005.

would be acknowledged by Members, then this would allow to reduce the allowed total AMS from the caps of the applied product-specific AMS of the base period to be decided, particularly of the applied cotton AMS.

**e) The base period to cap the product-specific AMSs**

The C4 proposes to consider the years 1995 to 2000 – of the AoA implementation period for developed countries – as the base period to calculate the average cotton subsidies notified to the WTO from which to operate the reduction of cotton domestic subsidies. In so doing the C4 joins the EU and G-20 proposals to cap the product-specific AMSs, the USA proposing the 1999-2001 period.

If the issue were to *cap* the product-specific AMSs in general and particularly of cotton, it would not be in the C4's interest that the USA could choose as base period the years 1999-2001 since their applied product-specific AMSs, particularly of cotton, were the highest. On the other hand if the issue is to *reduce* the applied AMSs and notably that of cotton – which neither the Framework Agreement nor the Hong Kong Declaration have intended to do – then the C4's interest is to retain the last years rather than the 1995-2000 period, being paradoxically closer to the US position for capping the product-specific AMSs.

Table 1 – Allowed and applied US total AMS and product-specific AMSs, notably of cotton

\$ billion (B\$), million (M\$)	1986/88	1995	1996	1997	1998	1999	2000	2001	1995/00	1999/01
Allowed total AMS (B\$)	23.879	23.08	22.28	21.49	20.695	19.899	19.103	19.103	21.093	19.368
Applied total AMS "	23.879	6.213	5.898	6.238	10.392	16.862	16.803	14.413	10.401	16.026
Applied specific AMSs "	23.879	6.214	5.898	6.238	10.392	16.862	16.803	14.413	10.401	16.026
Applied cotton AMS (M\$)	-	32	3	466	935	2,353	1,050	2,810	623	2,071

Source: annual notifications to the WTO

However to take as base period either 1995-00 or 1999-01 contradicts totally the Framework Agreement (paragraphs 7 to 9) which states that the reduction in the total AMS should start from the final *bound* total AMS, which was reached only at the end of 2000 in the US case and in June 2001 (end of the marketing year 2000-01) in the EU. It is therefore impossible to use a different base period for capping, and in fact binding, the *applied* product-specific AMSs, and the base period should begin at the earliest in January 2001 for the US and July 2001 for the EU (their last notified marketing years). And it is from that marketing year that the implementation period for capping the product-specific AMSs, then also for cotton, should begin.

To be sure the USA and EU have an overdue of 4 years in their notifications, and we know why: since the USA want to notify its contra-cyclical payments in the new blue box created by the Framework Agreement, it avoids the dilemma of notifying them either in the green box – which would clearly be impossible to justify as these payments are a function of the price level – or in the amber box (AMS) since it would be very difficult to notify them afterwards in the blue box. As for the EU, it avoids to show that its applied AMS (and blue box) has slumped since July 2002.

There is however a political time limit not to be exceeded to notify and it is up to the other WTO Members to remind the EU and USA that the Committee on agriculture has decided the 8 June 1995 that "*A notification should be made no later than 90 days following the end of the calendar (or, marketing, fiscal, etc.) year in question. Where the notification submitted within the 90 day period is provisional, the final notification should be submitted no later than 120 days following the end of the year*"<sup>3</sup>. Advocating, as the US and EU are doing, that the overdue is an insuperable technical constraint due to the minimum delay to collect all the necessary data is totally contradicted by the prompt transfer of the same data to OECD, few months after the end of the marketing year, so that OECD is able to publish its annual report on "*Agricultural policies in OECD countries. Monitoring and evaluation*".

**f) How to get out of this legal wood?**

Facing these contradictions between the reduction statements of the Framework Agreement and the Hong Kong Declaration on the level of the *allowed* OTDS and the C4's expectations on the level of

<sup>3</sup> Committee on agriculture, *Notification requirements and formats*, WTO, G/AG/2 of 30 June 1995.

the *applied* OTDS, is it possible to find ways out? The issue is clearly political but there are legal constraints that Members will not miss to raise, particularly the USA whose highest interests is to alleviate those reductions. The USA has kept linking the issue of domestic supports on cotton to the success of the agricultural negotiations in general and of the broader agenda of the Doha Round.

There is clearly a need for a new C4's communication to the Cotton Sub-Committee to demand that the reduction for cotton will be made from the actual applied level, the more so that there does not exist an allowed (or bound) level of domestic support for cotton. For this the C4 can rely on the following arguments:

- The fact that the Hong Kong Declaration has written: "*We recall the mandate given by the Members in the Decision adopted by the General Council on 1 August 2004 to address cotton ambitiously, expeditiously and specifically*". The word 'specific' should permit to calculate the reduction from the *applied* level and not the *allowed* level. However an explicit endorsement by the Sub-Committee on cotton is necessary, which should be confirmed by the General Council.

- The EU commitment, confirmed the 18 November 2005, that, "*As part of the DDA the EU has proposed immediate benefits for West African cotton producers: • The elimination of all forms of export subsidy for cotton; • The provision of quota and duty-free market access for all cotton imports; • A substantial reduction of trade-distorting domestic support for cotton producers. The EU has argued that these commitments should come into effect from day one of the implementation period final Doha Agreement, reflecting the urgency of the situation faced by cotton producers in West Africa. The EU will in due course call on its partners to offer the same*"<sup>4</sup>.

Nevertheless those arguments do not have the same legal binding as the Framework Agreement and the Hong Kong Declaration, which renders necessary a new WTO's decision to remove that ambiguity.

### **3) The C4 is confusing domestic supports in general with those on exported cotton**

Even if the previous difficulty on the possibility to reduce the domestic trade-distorting supports to cotton from its applied level were eliminated, the C4 reduction proposal is again very shy and ambiguous since it puts on the same level the domestic trade-distorting supports to cotton and the domestic trade-distorting supports in general when there are not at all on the same level, particularly the US ones which are the first aimed at. As mentioned, the C4 proposes simply to fix slightly higher reduction rates of the allowed OTDS for cotton than for all products.

#### **a) The US cotton producers do not appreciate the C4's proposals**

Our analysis is poles apart from the reaction of the Chairman and Manager of the US National Cotton Council (NCC) who declared on March 3, 2005: "*The C-4 has tabled a new proposal that goes well beyond the negotiating parameters established in the July '04 Framework Agreement and the Hong Kong text. Most of their proposal has no support in either of those documents. The C-4 countries are trying to re-negotiate the overall parameters for an agreement*"<sup>5</sup>. Incidentally the NCC has likely in mind the C4's implicit intention that the reductions be operated from the actual level of subsidies, which is not in line with the Framework Agreement and Hong Kong Declaration provisions.

#### **b) The percentage of the US cotton production which is exported**

When both texts are dealing with the OTDS and its three components (total AMS, *de minimis* supports, blue box) they refer to domestic supports in general, regardless they are benefiting or not to exported products and the reduction to be made is the same when no subsidized product is exported. Let us underline for the sake of simplification that, since cotton does not receive any market price support linked to an administered price – neither in the USA nor in the EU –, all domestic supports to cotton are subsidies.

Table 2 shows the evolution of the exported percentage of the US cotton production.

<sup>4</sup> Rencontre entre Peter Mandelson, Commissaire chargé du commerce, et Toumani Touré, Président du Mali: l'Union rappellera ses engagements de Doha relatifs au commerce de coton - Bruxelles, le 18 novembre 2005.

<sup>5</sup> <http://www.cotton.org/issues/2006/c4statement.cfm>

Table 2 – Evolution of the US cotton production and exports

Million bales (480 lb)	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 E
Production	18.793	13.918	16.968	17.188	20.303	17.209	18.255	23.251	23.161	23.700
Exports	7.500	4.298	6.750	6.740	11.000	11.900	13.758	14.409	16.200	15.800
Exports/production	39.91%	30.88%	40.30%	39.21%	53.28%	69.15%	75.37%	61.97%	69.95%	66.67%

Source : <http://www.ers.usda.gov/publications/so/view.asp?f=field/cws-bb/> E: estimate on 10 February 2006

### c) The domestic subsidies to exported cotton are export subsidies

Since 70% (69.95% precisely according to the Cotton Outlook of 10 February 2006) of the US cotton production have been exported in 2005, an identical percentage of the domestic subsidies are export subsidies, and this apart from the specific export subsidies (part of Step 2 and export credit guarantees) which will be eliminated in 2006.

Tables 3 and 4 show the evolution of the US domestic subsidies to cotton, the bulk of which are delivered through the USDA Commodity Credit Corporation, to which have to be added the agricultural insurances subsidies (table 3), very significant for cotton, and for which we will use the \$19 per acre figure used by Daniel Sumner<sup>6</sup>, which we will rise to \$29 since the USDA has only notified to the WTO 65% on average between 1999 and 2001 (last year notified) of its actual insurance subsidies, not taking into account the subsidies given to the insurance companies and its administrative costs<sup>2</sup>. The data relate to fiscal years (from 1<sup>st</sup> October to 30 September).

Table 3 – Estimates on US insurance subsidies on cotton

Million acres and million \$	1997	1998	1999	2000	2001	2002	2003	2004	2005
Acreage in cotton	13.898	13.393	14.874	15.517	15.769	13.958	13.480	13.659	14.184
Insurance subsidies on cotton (29\$/acre)	403	388	431	450	457	405	391	396	411

Source : USDA et Daniel Sumner (note de bas de page n°2).

Table 4 – Total domestic subsidies on cotton and to exported cotton from 1997 to 2006

Billion \$	1997	1998	1999	2000	2001	2002	2003	2004	2005 E	2006 E
Subsidies from the CCC	0.561	1.132	1.882	3.809	1.868	3.307	2.889	1.372	4.281	3.568
Cotton insurance subsidies	0.403	0.388	0.431	0.450	0.457	0.405	0.391	0.396	0.411	0.411
Total cotton subsidies	0.964	1.520	2.313	4.259	2.325	3.712	3.280	1.768	4.692	3.979
	0.385	0.469	0.932	1.670	1.239	2.567	2.472	1.096	3.282	2.653

Source : <http://www.ers.usda.gov/publications/agoutlook/aotables/2005/12dec/aotab35.xls>; Cotton Outlook 10 February 2006 E: estimates as of November 2005, therefore highly reliable for the civil year 2005, less for 2006.

### d) Formal subsidies on exported cotton

It is difficult to find data on the Step 2 subsidies and export credit guarantees to cotton. For Step 2 the WTO Appellate Body report of 3 March 2005 gives the data for 1999 to 2002 (table 5), and the Environmental Working Group gives \$264 million for 2004 for the whole Step 2 and, assuming that the share going to exporters have stayed at the 1999-2002 level of 35.9%, we can deduct the amount for 2004: \$95 million.

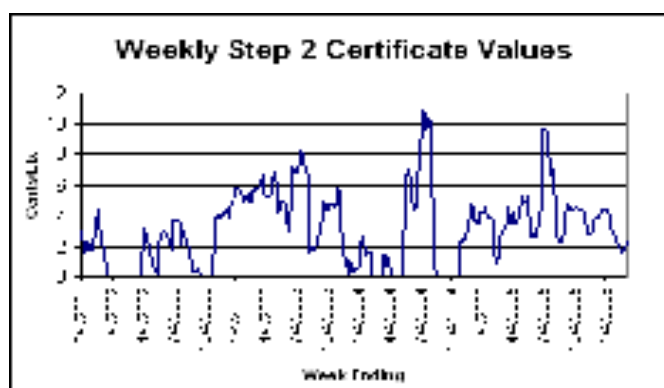
Table 5 – US subsidies to the Step 2 program from 1999 to 2004

Million \$	1999	2000	2001	2002	2004
Total Step 2	279	445	236	178	264*
of which to domestic cotton users	166	260	145	72	169*
of which to exporters	113	185	91	106	95*

Source: Appellate Body Report on cotton of 3 March 2005, pp. 352-53. \* The global amount for 2004 is given by the Environmental Working Group (<http://www.ewg.org/issues/agriculture/20050609/step2analysis.php>).

Lacking the Step 2 figure for 2005, we can estimate it from the following graph showing the Step 2 certificate values on which the subsidies are based: the graph suggests that the average amount for 2005 may have been higher than that of 2004 by 25%, which would give \$119 million for the export share of Step 2.

<sup>6</sup> Daniel Sumner, *A quantitative simulation analysis of the impact of US cotton subsidies on cotton prices and quantities*, University of California, 2002 ([http://www.fao.org/es/ESC/common/ecg/47647\\_en\\_Sumner.pdf](http://www.fao.org/es/ESC/common/ecg/47647_en_Sumner.pdf)).



As for the subsidy component of the export credit guarantees, the data are even more imprecise and scarce as the panel and Appellate Body reports on the cotton case have shown, since the panellists have not been able to decide between the multiple figures put forward by the USA and Brazil. These data by the way are related to all exported agricultural products and not to cotton specifically. However the available annual audit reports of the USDA Commodity Credit Corporation (CCC) show that the subsidy related to defaults to these export credits has been modest but has increased from \$40 million in 2002 to \$185 million in 2005. We can add \$4 million in annual costs for the CCC management of the program as indicated by the cotton panel report (paragraph 7.840). Assuming that the cotton share in export credit guarantees – 7% according to Oxfam for 2002<sup>7</sup> – has remained the same from one year to the other and the default rate has also remained the same for all credits, this would imply a subsidy passed from \$3 to \$13 million, a negligible amount in relation to domestic cotton subsidies.

Table 6 – Estimates of the subsidy component of the credit guarantees to exported cotton

Million \$	2002	2003	2004	2005
Total credit guarantee subsidies (defaults + \$4 million in management costs)	44	104	131	189
Subsidies to exported cotton (7% of total)	3	7	9	13

Source: USDA, Office of the Inspector General, Commodity Credit Corporation Financial Statements for FY 2002 to 2005.

#### **e) The US total subsidies to exported cotton**

Finally we see that total subsidies to exported cotton have been limited to \$109 million in 2002, \$104 million in 2004 and \$132 million in 2005 (data are missing for all years from 1997 to 2005).

As total subsidies to cotton are estimated at \$4.692 billion in 2005 – they have never been so large –, this will make \$4.560 billion in alleged domestic subsidies, of which 69.95% or \$3.190 billion are actual export subsidies.

Which implies that total export subsidies have reached \$3.322 billion in 2005 (fiscal year 2005-06 from October 2004 to September 2005) and that the \$132 million in formal export subsidies which will be eliminated the 1<sup>st</sup> August 2006 account for only 3.0% of the total US export subsidies to cotton!

But we can as well estimate the cotton export subsidies for the civil year 2005 and the first 7 months of 2006, which ends the marketing year and the date at which the USDA has decided to eliminate all its export subsidies on cotton of the marketing year 2005-06 (from August 2005 to July 2006). The USDA tables for 2006 that 66.67% of the cotton production will be exported and that the cotton subsidies would be of \$3,568 billion. Adding the subsidies on cotton insurances based on the expected acreage in cotton, and on the same amount of formal export subsidies on cotton as in 2005 (the export share of Step 2 + export credit guarantees), the elimination of export subsidies would be of \$2.697 billion [66,67% of (3.979-132) + 132].

#### **f) The legal basis assimilating the domestic subsidies to export subsidies**

<sup>7</sup> Oxfam, *US export credits: denials and double standards*, Oxfam America Briefing Note March 2003.

When the Hong Kong Declaration (paragraph 11) states that "*All forms of export subsidies for cotton will be eliminated by developed countries in 2006*", the words "*all forms*" allow to consider as such domestic subsidies benefiting to exported products, so much so as we can rely on the rulings of the WTO Appellate Body, not only that of 4 April 2005 on US cotton but also those of 3 December 2001 and 20 December 2002 on Dairy Products of Canada. The December 2001 ruling (paragraph 148) states: "*The distinction between the domestic support and export subsidies disciplines in the Agreement on Agriculture would also be eroded if a WTO Member were entitled to use domestic support, without limit, to provide support for exports of agricultural products* (paragraph 91)... *The potential for WTO Members to export their agricultural production is preserved, provided that any export-destined sales by a producer at below the total cost of production are not financed by virtue of governmental action* (paragraph 92)".

And the Appellate Body ruling of December 2002 repeats (paragraph 148): "*If governmental action in support of the domestic market could be applied to subsidize export sales, without respecting the commitments Members made to limit the level of export subsidies, the value of these commitments would be undermined. Article 9.1(c) addresses this possibility by bringing, in some circumstances, governmental action in the domestic market within the scope of the "export subsidies" disciplines of Article 3.3*".

By the way, the judgment of 4 April 2005 on cotton refers to these two legal precedents.

**g) We need to integrate in the domestic trade-distorting subsidies many subsidies from the alleged blue and green boxes**

The USA will clearly object that the reduction of domestic trade-distorting supports (total AMS + *de minimis* supports + blue box) excludes those put in the green box or at least supposed to be there by the USA and EU. But, except if we deny that the WTO Appellate Body's rulings create precedents, that of 3 March 2005 on cotton has stated that the "production flexibility contracts payments" and the "direct payments" which have replaced them in 2002 cannot be in the green box since cotton producers were not (and are not) allowed to grow fruits and vegetables.

Besides the domestic subsidies considered by the Commodity Credit Corporation do not take into account the other green box subsidies, not only the various subsidies allowed by the AoA Annex 2 paragraphs 5 to 13 of which the G-20 challenges correctly the legitimacy – payments for relief from natural disasters; payments under environmental programmes, payments under regional assistance programmes, structural adjustment assistance provided through investment aids, producer retirement or resources retirement, without forgetting the decoupled income support the criteria of which the EU and USA are not complying with – but also those of paragraphs 1 to 4 that the G-20 does not question, wrongly<sup>8</sup>.

We should finally add irrigation subsidies to cotton, for a minimum of \$47 million, that the Commodity Credit Corporation does not consider<sup>1</sup>.

**h) The USDA confesses that the elimination of export subsidies will increase domestic subsidies**

It is impossible to justify legally putting the counter-cyclical payments in the new blue box even if it has been created by the Framework Agreement precisely with this objective, since they are inversely function of the price level. Precisely, according to Keith Collins, the USDA's Chief economist, although the elimination of the Step 2 subsidies and of the export credit guarantees will have a depressive effect on the domestic cotton price, this would hardly change the total subsidies since the lower cotton price will trigger higher counter-cyclical payments: "*Collins said that the removal of Step 2 would result in slightly lower domestic prices – by two to three cents per pound – and higher export prices for U.S. cotton. But he also anticipated that declines in producer prices would be likely to trigger an increase in counter-cyclical payments (CCP) to U.S. cotton farmers that would offset losses from lower prices. Hence, some of the budgetary savings from eliminating Step 2 would be negated by the required additional outlays for commodity price support*"<sup>9</sup>.

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<sup>8</sup> Jacques Berthelot, *The green box a black box which hides the gold box*, Solidarité, December 9, 2005.

Therefore the Benin Representative was fully right to declare the 28 October 2005, at the 7<sup>th</sup> meeting of the Cotton Sub-Committee: "*The Member countries concerned should therefore make concrete proposals on cotton relating to... the elaboration of disciplines that prohibit changing unauthorized support into authorized support and enable it to be monitored*". However his words clearly did not convince those who did not want to hear them.

#### **4) We should not forget the dumping of the EU cotton**

The overwhelming pre-eminence of the US cotton dumping should not blind us on the EU one. Even if the EU is the second largest net importer of cotton (after China), it has nevertheless exported on average 41.7% of its production of 506,000 tonnes from 1997 to 2003 and the fact that its producers are paid the world price, and that there is consequently no export refunds – there is not either any tariffs on cotton imports –, should not hide that the EU cotton is the most subsidized per tonne. Although the EU accounts only for 2.5% of world production, the subsidies to Greek and Spanish producers account for 18.5% of world cotton subsidies. Therefore 41.7% of the EU subsidies to its cotton producers are export subsidies, that is €341 million on average in the period.

Tableau 7 – Exports of EU cotton and subsidies to EU cotton from 1997 to 2003

1000 tonnes and million €	1997	1998	1999	2000	2001	2002	2003	Moyenne
Production (1000 tonnes)	478	501	572	521	542	476	435	506
Imports "	932	857	691	761	676	686	532	734
Exports "	178	130	251	234	222	207	255	211
Exports as % of production	37.2%	25.9%	43.9%	44.9%	39.6%	43.5%	58.6%	41.7%
Apparent consumption "	1.232	1.228	1.012	1.048	996	955	712	1.026
Subsidies to cotton (million €)	800	761	903	855	733	804	871	818
Subsidies to exported cotton "	298	197	396	384	290	350	510	341

Source : FAOSTAT et UE

Although the CAP reform of April 2004 has decided to transfer 65% of these production subsidies from the amber box to the "single farm payment" (SPF) that the EU claims to be in the AoA green box, this claim does not stand up to the scrutiny. The SFP is in the amber box of subsidies submitted to reductions since it does not obey to 3 out of 5 criteria imposed by the AoA (Annex 2 paragraph 6) on "Decoupled income support": (1) it is based on the amount of direct payments received from 2000 to 2002, a criterion not provided for; (2) it remains coupled to the eligible hectares since farmers must show they have them to get the annual SFP; (3) farmers are not allowed to produce what they want since many productions are forbidden (fruits and vegetables, milk and sugar if they do not have a quota) or capped (milk and sugar cannot exceed the quota levels and caps are put on cotton, tobacco and olive oil).

Then the WTO Appellate Body has stated the 3 March 2005 that the US "direct payments" to their cotton producers, allegedly decoupled and in the green box, were coupled since they were not allowed to grow fruits and vegetables. But, as we have just shown, the interdictions to produce are much broader for the SFP, so that there is no question it will be condemned before long, as soon as a legal action will be instigated at the WTO by any Member. ACP countries should do it urgently.

Besides, as farmers getting the SFP are not obliged to produce specific products – they can even not produce anything provided they maintain the lands in a productive capacity –, the SFP cannot be ascribed to a specific production and is therefore attributable to all products, of which it reduces the production costs. Hence, all EU exported agri-food products can be sued on dumping.

Clearly the decoupling of 65% of cotton production subsidies should foster a significant drop in the production of cotton but, as long as the EU will go on producing and exporting cotton, the dumping will remain. Therefore the C4 should not forget to demand that the EU be subjected to the same treatment as the USA, otherwise its argument would lose in credibility and legitimacy.

<sup>9</sup> Randy Schnepf, *U.S. Agricultural Policy Response to WTO Cotton Decision*, Congressional Research Service, July 11, 2005.

However, since Carlo Trojan, the EU Ambassador to the WTO, has declared in the meeting of the Sub-Committee on cotton the 18 November 2005: "*The EU says it is willing to eliminate all duties, quotas and other quantitative restrictions on imports from all countries, the most trade-distorting domestic supports (AMS), and all export subsidies, from "day one" (the first day that the final agreement is implemented), and to apply disciplines on Blue Box subsidies from "day one". "Moreover, on an autonomous basis, the [EU] is prepared to give an assurance to cotton producer countries that all these commitments will already be in place, as far as the [EU] is concerned, from 2006," EU Ambassador told the meeting*", the C4 should take it at his words, which means on eliminating all domestic supports to its exported cotton since it has no tariffs and no export subsidy. Precisely he could have omitted to say the EU agrees to eliminate all duties and quotas on cotton imports and all export subsidies since the it does not use any of them!

### **5) Finally there is no need to reduce the domestic supports not going to exported cotton**

The WTO Members, notably the C4, go astray in demanding to reduce all trade-distorting domestic supports independently of the fact they benefit or not to exported products, and this by lack of a clear definition of what we should understand by "trade distortion". For sure, for the neo-liberal doctrine embodied in OECD, it encompasses all supports which render the domestic products more competitive than foreign ones, implying border supports (import protection and export subsidies) and domestic supports included in total AMS (without deducting the *de minimis* supports) and the blue box subsidies since the Framework Agreement (they are exempted from reduction as long as the Doha Round would not be finalized, on the condition however to comply with the AoA conditions, what the EU is not doing).

Actually the only true trade distorting supports are those doing a positive harm to other countries, those which convey "offensive interests" of exporting countries, which are dumping factors: not only formal export subsidies but also all domestic supports benefiting, directly or indirectly, to exported products, including upstream the production level (subsidies on inputs, without forgetting feedstuffs, and investments), downstream (on the processing and domestic marketing) and the crossed subsidies.

Therefore, although subsidies are mainly affordable to rich countries, they are not bad in themselves and should be allowed as long as they do not have any direct or indirect dumping effect. But the distinction between the red, amber, blue and green boxes is irrelevant and useless on fair trade grounds. That the green box subsidies are benefiting the environment does not rule out that their beneficiaries are farmers whose production cost is thus reduced, allowing them to sustain domestic prices lower than this cost, with dumping effects if the product is exported and simultaneously substitution effects at the import level.

Even if large farmers can export without subsidies, the fungible nature of agri-food products included in every export contract – where it is impossible to identify the origin of products depending they come from large farms with a low unit production cost or from small ones with a high unit production cost – implies a simple rule to define dumping, which can only be the fact to export at a price lower than the average production cost of the WTO Member without any direct or indirect subsidy.

And, paradoxically, import protection is the form of agricultural support the least protectionist for all countries and should be recognized as such at the WTO. It is indeed the only agricultural support affordable to poor countries whereas subsidies are the most protectionist support since they are only affordable to rich countries. Above all because rich countries can use them to compensate their farmers for the reduction of agricultural prices to their world level so that there is no longer a need of an import protection since the agri-food corporations and the domestic traders can buy the agricultural products at the world price on the domestic market. This explains the EU and US proposals to reduce largely their agricultural tariffs, as long as they can increase their allowed subsidies of the blue and green boxes.

If every country should have the right to use an import protection, this should not allow it to export with dumping due to a cross-subsidization of prices, the best examples rightly condemned at the WTO being those of Dairy products of Canada (judgments of 3 December 2001 and 20 December 2002) and EU sugar (judgment of 5 April 2005): the EU sugar hardly receives domestic subsidies and the only

export refunds notified at the WTO are financed by producers contributions (those financed by the EU budget and corresponding to the re-export of previously imported raw sugar from ACP countries after processing in refined sugar in the EU are not, wrongly, notified). But it is the high import protection – allowing the domestic prices of sugar to be 2 to 3 times the world price –, linked to quotas levels largely exceeding domestic needs, which has created huge surpluses, notably of 'C sugar' bought and exported at the world price, hence formally without dumping. The Appellate Body has rightly ruled that the world price at which the C sugar is paid is largely below production cost and that the producers are only producing it because they receive very high prices for the A and B sugar, so that they can produce the C sugar at the marginal cost covering only the variable costs.

In other words the C4 should not demand that the USA and EU reduce their domestic supports on non exported cotton – including the major part of Step 2 subsidies going to the US textile industry for its non exported products –, but that, on the other hand, all domestic subsidies to exported cotton be eliminated, including those of the blue and green boxes. After all, if the USA and EU are willing to maintain or even increase their cotton production for their domestic needs, they should be free to increase their import protection and/or their domestic subsidies, as long as they will no export any cotton and will no longer harm more competitive countries able to export without dumping.

But there is a deeper reason not to produce cotton any longer in the EU with the prospect of rebuilding national agricultural policies and the AoA on food sovereignty. Rebuilding the CAP on food sovereignty implies that farmers be remunerated essentially through prices covering the EU average production cost, then the production cost of 50% of production of every basic agricultural product, only the farmers producing the second half being eligible to a complementary income subsidy capped per active worker, given the multifunctionality of agriculture.

However it is clear that the present difficulties of the textile-clothing chain in the USA and EU – linked to the massive imports of Asian garments (notably Chinese) since the elimination of import quotas the 1<sup>st</sup> January 2005 – prevent any significant increase of the domestic prices of cotton and/or clothes, so that an increased import protection on cotton is excluded since the textile industry and consumers would hardly accept a large increase in the price of clothes. So much so in the EU that the rise in the cotton price should be dramatic since direct payments to cotton producers represent 2 to 3 times the world price.

## **6) An easier access to the developed countries market will not increase the LDCs' cotton exports**

### **a) It will have hardly any effect on the USA**

The fact for the USA to have agreed to import duty free African cotton is a very cheap promise since, despite the low level of its tariff rate quota on 5% of the cotton domestic consumption – the duty inside the quota going from 0 to 4.4 cents/kg, against 31.4 cents/kg beyond the quota –, the US imports have stayed much below the quota from 2000 to 2004: at 8,367 tonnes on average, i.e. 12.1% of the tariff quota of 68,670 tonnes). Indeed these imports are so insignificant that they are considered as nil in the statistical tables on the 'supply and disappearance' tables for cotton. Moreover they can only decrease (although it would be difficult being already almost nil) since the tariff quota is a percentage of the domestic consumption by the textile industry which is facing a high slump due to the intensified competition of imported Chinese clothing, having dropped from 11.4 million bales (i.e. 2,485 million tonnes, 1 bale=218 kg) in 1997-98 to 6.3 million bales (1.373 million tonnes) in 2004-05. Which explains the necessity for the USA to export an increased share of its cotton production.

As the bill of February 2006 having suppressed the Step 2 subsidies from the 1<sup>st</sup> August 2006 relates not only to the part granted to exporters but also to that going to the US textile industry – condemned by the cotton panel as contradicting the national treatment clause (GATT article 3) –, this should incite it to buy more imported cotton than domestic cotton, but the main result will be the necessity to export an ever increased share of production. Then, even if WTO Members would succeed in opposing to put the US counter-cyclical payments in the new blue box, as long as the green box subsidies would not be capped, the USA could go on increasing their compensatory payments to the cotton farmers and processors as much as they want to go on dumping.

## **b) It will not have a larger impact on the EU**

Table 7 shows that the EU cotton imports are decreasing sharply – by 42.9% from 1997 to 2003 – a percentage close to the 42.2% drop in the apparent consumption (production + imports – exports) since the cotton production has been almost flat. But the EU cotton consumption will drop even more as a result of the textile industry crisis linked to the jump in imports from Asia since January 2005. Therefore, even if the full decoupling of 65% of cotton subsidies to the Greek and Spanish farmers should foster a significant drop in the cotton production level, the textile industry crisis has more chance to translate eventually in a drop of cotton imports rather than in their rise.

## **7) The IMF's irresponsible views on the future of African cotton producers**

The IMF's analysis of African cotton in May and October 2005 illustrates its unshakable faith in the unavoidable nature of trade liberalisation and in the obligation to adjust to it, willy-nilly. It notes first the dramatic impact of the drop in the world price of cotton: *"The impact of the decline in the world price of cotton is most severe in Benin, Burkina Faso, Mali, and Togo. For these four countries, cotton*

*exports amount to 5–8 percent of GDP, and cotton production provides employment for as much as one-third of the population. The recent decline in cotton prices could reduce cotton exports by about 2–3 percent of GDP in these countries, resulting in a decline in real income, a domestic economic contraction, a widening of external current account deficits, and a worsening of poverty. The loss of export revenue would be roughly equivalent to one-third of net official financial flows to these four countries"*<sup>10</sup>.

Indeed, after having dropped in 2004 by 30% in \$ and 40% in €, the New-York price is at 56.05 cts/lb the 10 March 2006. It is much better than the bottom of 28.52 cts/lb the 25 October 2001 but much worse than the average level of the years 1994-99 as shown in the graph.

The cotton price in New-York



Source: Les Echos of 10 March 2006.

The IMF's diagnosis of the current situation and prospects for cotton and its therapy are alarming: *"The available data (for example... suggest, at best, a moderate rebound in world cotton prices, with prices remaining well below historical averages for the next five years. Under these circumstances, world price signals need to be passed through to domestic producers, to allow for efficient planting decisions"*. Consequently, *"The IMF staff estimates that, at current world prices and ginning margins, the producer price would need to fall by at least a third to eliminate export losses without government subsidies"*. This is a piece of information which will interest the African cotton growers!

The most surprising is that, despite the condemnation of the US cotton export subsidies by the WTO Appellate Body in March 2005, and despite the on-going negotiations within the Sub-Committee on cotton, the IMF concludes: *"Despite this development in the WTO, it is unlikely that distortions in the world cotton market will be eliminated in the near future. For their part, African producers need to*

<sup>10</sup> IMF, *Regional economic outlook, Sub-Saharan Africa*, May 2005, <http://www.imf.org/external/pubs/ft/AFR/REO/2005/eng/01/SSAREO.htm>

*continue pursuing efficiency gains and could increase the use of hedging mechanisms, if available, to reduce and diversify risk".*

This advice is totally unrealistic because: 1) these instruments are out of reach of African farmers organisations and, even in the USA, futures markets are used only by a tiny minority of farmers; 2) they can cover at best the prices fluctuations of a marketing year but can do nothing against a structural overproduction; 3) above all, using futures markets is incompatible with any public regulation to manage the agricultural supply nationally and at the international level.

The IMF report of October 2005 is not more delightful: "*In general, producer prices for 2005/06 in the region will be lower than for the previous season, which will help reduce, if not eliminate, financial losses in 2006... A step-up in assistance by the international community would allow African countries to adjust to lower cotton prices and improve competitiveness*"<sup>11</sup>.

## **8) Conclusion**

To save their cotton producers the WTO African Members and their spokesperson of the C4 must have a change of heart and readjust their strategy. They should realize that, beyond their nice speeches, their main partners – the EU, the USA and the IMF, their armed arm – will not let them off lightly and will follow selfish interests. They must understand that the WTO Agreements – the AoA, the Framework Agreement and the Hong Kong Declaration – are full of traps since they have been devised by these powerful Members to perpetuate their dumping through transferring their subsidies from a 'box' alleged to be trade-distorting to others supposed to be less or no trade-distorting, and through massive cheatings in their notifications and in the compliance of their agricultural policies with those rules.

Since the C4 claims to lean on these WTO rules, it should lean also on the case law of its Dispute Settlement Body to demand that all domestic subsidies going to the exported cotton be considered as export subsidies and eliminated in 2006. At the very least it should demand that the major part of domestic subsidies, those going to the exported cotton, be subjected to a much higher and quicker reduction than that it has proposed the 1<sup>st</sup> March for cotton domestic subsidies in general. Besides, it should renounce explicitly to the elimination of subsidies to the non exported cotton, which would allow the USA to keep the major part of the Step 2 going to its textile industry and will facilitate their agreement to eliminate all subsidies to the exported cotton.

Beyond these profound adjustments which will be politically difficult to obtain, the C4 and with it all African countries and more generally the LDCs and ACPs should admit they are playing at the WTO on a field where they can only go on loosing since the rules are not at all adapted to their development level and furthermore they are not complied with by the most powerful Members. Developed countries deny them to use the main rule which has allowed them to access to their present development level: a high import protection of their domestic market in all sectors and even more in agriculture. By the way it is an import protection they can manage without to-day to a large extent since, in exchange of massive subsidies of the allowed blue and green boxes, their farmers can make do with the alignment of domestic prices on their world levels, so that the agri-food industries no longer have an incentive to import.

But this rule has also played for emerging countries such as Brazil and India which have been able to industrialize under the cover of a high import protection, not only for agriculture but also for industry: Brazil has begun to open its domestic market in the early 90s and India in the late 90s, and not without harm to their poor farmers.

The United Nations estimate that the population of the Sub-Saharan Africa (SSA) would jump from 752 million in 2005 to 1.729 billion in 2050, a rise by 130%. Which future are the SSA Members preparing to them if they go on accepting the WTO rules, what is more not respected by its most powerful Members? And if they accept the even worse rules of the Economic Partnership Agreements negotiated with – in fact imposed by – the EU, which will deepen greatly a food deficit already

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<sup>11</sup> <http://www.imf.org/external/pubs/ft/afr/reo/2005/eng/02/pdf/ssareo.pdf>

unfathomable and prevent the SSA to industrialize, given their lack of competitiveness, not to speak of the climate change? Was it responsible that, under the pressure of Western countries and of their armed arm of the IMF and World Bank, the ECOWAS has decided the 16 January 2006 to adopt the same common external tariff as the WAEMU, in which the maximum tariff is 20% and is of 5% for wheat and other cereals?

However, in the WTO report of 13 April 2005 on the trade policy review of Nigeria (WT/TPR/S/147), we read about agriculture: "*The sector is highly protected; the average tariff on agricultural products (ISIC, Revision 2) increased from 26.7% in 1998 to 41.4% in 2003, and several agricultural products (fruits, vegetables, grains) attract tariffs of 100%. In addition, import bans have been placed on products, such as wheat flour, sorghum, cassava, and poultry products*". More generally tariffs range from 2.5% to 150% and the average applied duties are of 50.2% for agricultural products and 25.3% for non agricultural products, whereas the bound tariffs (or allowed) go from the minimum of 40% to the ceiling of 150%. All tariffs on agricultural products are bound whereas only 7% of tariff lines on non agricultural products are. And the report adds that, together with other development policies, "*These measures have contributed to the recent robust growth in the (agricultural) sector*".

Even the World Bank has begun to make amends when it acknowledges, in its last Report on the World Development 2006, that, "*Most policy advice given to poor countries over the last several decades – including that by the World Bank – has emphasized the advantages of participating in the global economy. But global markets are far from equitable, and the rules governing their functioning have a disproportionately negative effect on developing countries. These rules are the outcome of complex negotiating processes in which developing countries have less voice. Moreover, even if markets worked equitably, unequal endowments would limit the ability of poor countries to benefit from global opportunities. Levelling the global economic and political playing fields thus requires more equitable rules for the functioning of global markets, more effective participation of poor countries in global rule-setting processes, and more actions to help build and maintain the endowments of poor countries and poor people.*"

The C4 countries cannot let the future of their sub-region rest on the exports of their cotton on a world market with highly volatile prices and depressed in the long run. Instead of going on importing 90% of their garments and assisting to the deepening of a food deficit which, apart from the exported tropical products (coffee, cocoa, cotton, rubber, leathers and skins) has already increased by 55% from 1995 to 2003 (from \$2.9 billion to \$4.3 billion) in West Africa (ECOWAS plus Mauritania), they must base their agricultural development on food sovereignty, through an efficient import protection of their domestic market, including for industry, particularly that based on the processing of their primary products, the textile industry first.