



Brazil Cotton Case Update

The United States and Brazil held another round of meetings under the bilateral cotton framework agreement on July 13 in Rio de Janeiro. The two sides likely discussed a variety of issues, including the development of the 2012 farm bill, U.S. cotton subsidies, and the U.S. House of Representatives June 17 vote to block a \$147 million annual payment to Brazil's cotton industry. This action by the House has prompted a great deal of hand wringing among those who follow trade, and for good reason.

To remind us all, the WTO ruled in 2005 and again on our appeal in 2008 that U.S. marketing loan payments, countercyclical payments, and export credit guarantees caused serious prejudice to the trade interests of Brazil. It also ruled that U.S. export credit guarantees for cotton and other commodities such as rice, soybeans, and corn under the GSM-102 program constitute illegal export subsidies. As a result, Brazil is entitled to impose about \$830 million per year in sanctions against the United States. The injury determination was large in and of itself, but what made the outcome unprecedented was that Brazil was granted cross retaliation. Cross retaliation means Brazil is entitled to impose sanctions not only on goods, but also services and probably most concerning, Intellectual Property (IP) rights. Understand that the WTO has said that as part of their retaliation package, Brazil can essentially throw patent protections we have on our IP, like pharmaceutical products or software, out the window.

Rather than face the full force of Brazil's retaliations, USDA struck an interim deal with Brazil in June 2010. Under the agreement, Brazil agreed to not impose retaliatory measures against U.S. exports, while the United States agreed to limit the use of its GSM 102 program, provide a \$147 million annual payment to Brazil to help its cotton sector, and continue discussions with Brazil on how to reform its cotton-specific farm subsidies. This deal was intended to bridge the time between the WTO ruling and the development of the 2012 Farm Bill, the next opportunity for the cotton subsidies in question to be brought into compliance. As such, the deal is set to expire at the end of 2011. However, efforts to bring this uneasy truce to an early end – such as the actions by the House - have left many wondering: What are the potential ramifications of non-compliance?

If the U.S. were to stop making its annual payment Brazil would most assuredly begin applying sanctions on U.S. goods and services to their full annual level of \$830 million. While Brazil is fully within its rights to change the retaliation list of products at any time, their actions in 2010 gave a good indication of what their strategy will be. On March 2010, Brazil announced its final list of tariffs and the preliminary IP/patent list. In the press release, Brazilian officials indicated that they would impose \$591 million of sanctions in goods and \$238 million in intellectual property, patent and services sanctions, such as for a limited time suspending U.S. patents on pharmaceuticals, chemicals and biotechnology, restricting copyrights in the music and audiovisual industry, and allow the government to increase fees and tighten regulations on

registration of intellectual property rights. The Brazilian's did not choose these products by chance. Between 2005 and 2010, U.S. exports of the 102 tariff lines on the retaliation list grew 219% by value. Over the same period, all other U.S. exports grew 111% by value. So what are these mystery products? Not what you'd expect, unless you closely followed the strategy used by Mexico in the trucking debate.

The list of goods is comprised of many consumer products, several of which are considered luxury goods. It includes among other things: yachts; cars; pharmaceuticals; medicines; medical equipment and supplies; select motor vehicles; tires; farm machinery; stand up freezers; plastic furniture; beauty products; radio and television broadcasting and wireless communications equipment. But it also includes some agricultural products such as a few fruits including dried grapes, pears, plums, and cherries; wheat; select condiments; miscellaneous processed foods; fabric; oh and cotton. The value of the products on Brazil's retaliation list surpassed \$800 million based on import figures from 2010.

At this point the retaliation list may seem a bit random, but let's circle back to the reference about the Mexican trucking dispute. In that case, Mexico targeted products that could easily be imported from other trading partners and products from states where Congressional members had voted to end the first Mexico trucking pilot program. Mexico's successful strategy of product targeting was not lost on Brazil, which is best demonstrated visually.

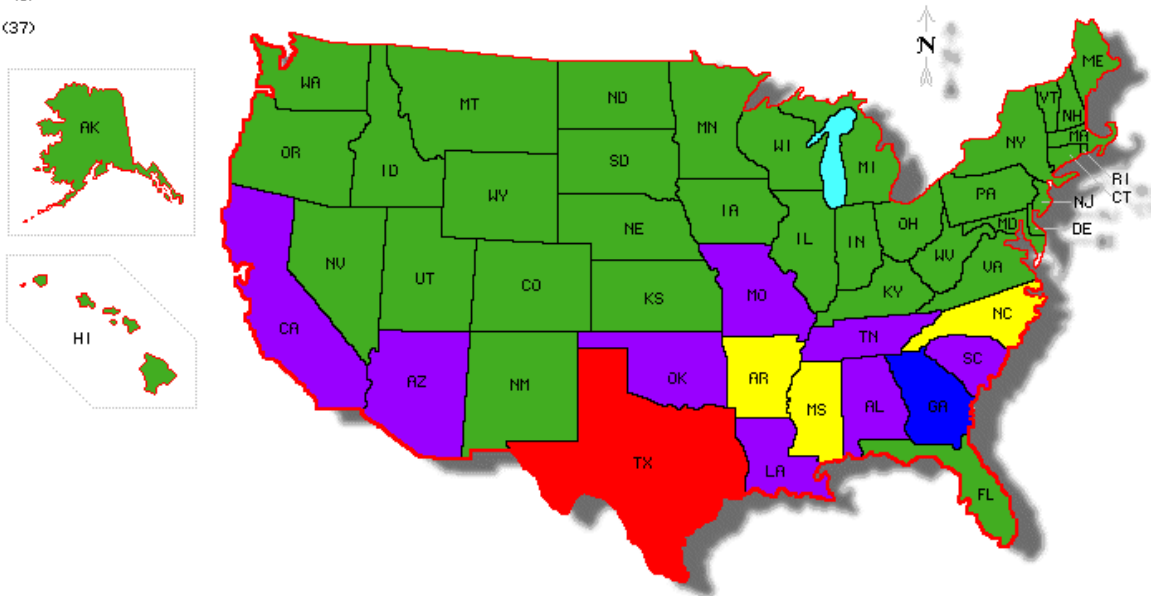
Using USDA data, the 2005-2010 average percentage of total upland cotton production has been mapped in **Figure 1**. Cotton is grown in 13 states, with Texas, Georgia, Arkansas, Mississippi and North Carolina accounting for 72% of production. In **Figure 2**, U.S. Census data on payroll density of the industries targeted on the Brazilian retaliation list have been mapped. What is immediately obvious is that the region where cotton is grown and the regions where the majority of the products on the retaliatory tariffs list are produced are not the same. It appears that Brazil will try to exert pressure on the U.S. to change its cotton subsidies by targeting products largely produced in states where cotton is not grown.

There are many steps between the House's 223-197 vote to amend a farm spending bill that would block the payment and actually stopping the payment. Many contend it is unlikely the Agriculture appropriations bill that contains the Brazil measure will become law. Both the Senate and the administration have to have their say. However, if enough votes can be found to end the payments to Brazil, officials there say retaliation is forgone conclusion. Then the really hard decisions will begin.

Figure 1.

2005–2010 Average Percentage of Total Upland Cotton Production

- - 38% (1)
- - 11% (1)
- - 6–10% (3)
- - <=5% (8)
- - ~0% (37)

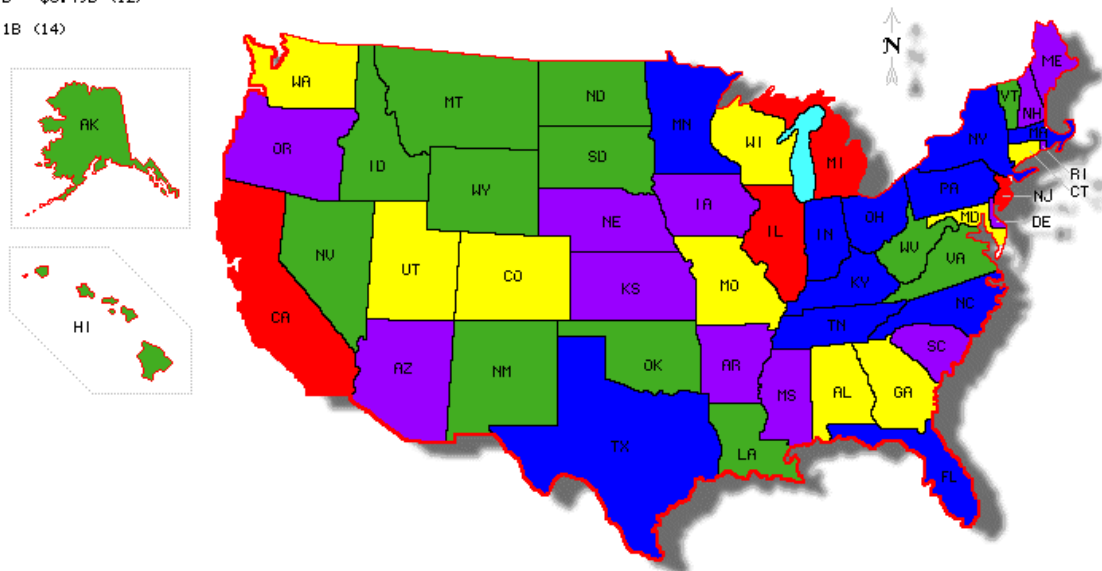


Source: Data: USDA, NASS; Map: American Farm Bureau Federation®

Figure 2.

Brazil 2010 Cotton Retaliation List by Payroll Density

- - \$4B - \$10B (4)
- - \$1B - \$3.99B (11)
- - \$0.5B - \$0.99B (9)
- - \$0.1B - \$0.49B (12)
- - <\$0.1B (14)



Source: Data: U.S. Census Bureau; Map: American Farm Bureau Federation®