

U.S.-Brazil Cotton Case – Retaliation Arbitration

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On August 31, 2009, the World Trade Organization ruled that American exports to Brazil will face \$294.7 million of sanctions as a result of the United States failure to remove illegal subsidies provided to domestic cotton producers. In the two-part, 269-page decision released on Monday, the Arbitration Panel awarded Brazil \$147.4 million in retaliation for export subsidies and \$147.3 million for marketing loan and counter-cyclical payments. The award is only about 10 percent of the \$2.68 billion originally sought by Brazil. This is the fifth major decision since the Brazilian government brought the case to the WTO in September of 2002. Some of the specifics of the arbitration panel's findings are discussed below.

Prohibited Subsidies (GSM Program)

Brazil requested a one-time countermeasure of \$350 million in retaliation to the failure of the United States to withdraw the Step 2 program payments before the July 1, 2005 deadline. However, the arbitration panel concluded that there was “no legal basis” for Brazil to seek countermeasures for past behavior and rejected Brazil's one-time retaliation request.

With regard to the GSM 102 and GSM 103 programs (collectively known as the export credit guarantee programs, which help U.S. provide credit to foreign purchasers) and the Supplier Credit Guarantee Program (SCGP), Brazil requested permission to apply a *variable* level of countermeasures against the United States. Brazil sought a countermeasure reflecting the advantages U.S. beneficiaries would not have been able to get in the marketplace, absent the U.S. government's financial contribution. Applying their proposed methodology to fiscal year (FY) 2006, Brazil calculated a proposed countermeasure of \$1.294 billion.

Brazil's proposed countermeasure was variable, on an annual basis, depending on “the total of exporter applications received under GSM 102 . . . for the most recent concluded fiscal year.” Brazil's methodology includes two elements. The first is the interest rate subsidy (IRS), which is the present value of the difference between the interest rate at which foreign borrowers would have been able to borrow in the absence of the GSM 102 credit guarantees and the subsidized interest rate provided to those borrowers under the GSM 102 program. The second element calculates the additional export demand created by the improved credit availability (additionality). This additionality is in two forms: full additionality from uncreditworthy borrowers who would not have been able to make any purchases absent the GSM program and marginal additionality from creditworthy purchasers who would not make the same size of purchases absent the GSM program.

Based on the formulas established for these calculations, the panel allowed Brazil \$147.4 million in a *variable* annual amount for the prohibited subsidies. However, this amount is to be adjusted with each fiscal year, depending upon the use of the GSM 102 program.

Actionable Subsidies (Marketing Loans and Counter-Cyclical Payments)

Brazil claimed that the adverse effects on the rest of the world from U.S. marketing loans and counter-cyclical payments (CCP) to be \$3.335 billion, but proposed countermeasures in the amount of \$1.037 billion in retaliation for the actionable subsidies. The United States disagreed with Brazil's calculation in reaching this number, pressing for a maximum of \$30.4 million.

The two sides argued over the reference period (Brazil pressing for a single year, assessing how much higher world market prices for cotton would have been absent the U.S. programs; the United States pressing for a three-year period, more representative of the recent evolutions in the global cotton market), elasticities (Brazil pressing for higher supply and demand elasticities; the United States pressing for lower elasticities based upon the FAPRI model), and coupling (Brazil pressing for a higher coupling factor for the CCP, indicating a higher degree of production incentive; the United States again pressed for FAPRI-based numbers with a lower coupling factor). In the end, the panel found that most of Brazil's recommendations were "within the range found in the relevant literature" and that the United States had not demonstrated that Brazil's proposed parameters were "inadequate."

So, the arbitration panel re-ran the "Sumner model" (the same model the panel has used throughout this dispute) based upon the new base period and determined that the adverse effects on the rest of the world from the U.S. marketing loan and counter-cyclical payments in marketing year (MY) 2005 amounted to \$2.905 billion (slightly lower than Brazil's original estimate).

However, the panel then accepted an argument from the United States and held that the level of countermeasure to which Brazil was entitled was only the price effect in *its* market, and not the value of the global market. The panel determined Brazil's share of global cotton production was 5.1 percent in MY 2005, so the original amount had to be revised downwards.

Based on this, the panel allowed Brazil \$147.3 million in a *fixed* annual retaliation amount for the actionable subsidies.

Application of Countermeasures

Brazil also requested authorization to suspend concessions or obligations under *other* WTO agreements. Brazil argued that, given the size of its countermeasure request (\$2.68 billion in total), it was "neither practicable nor effective" for Brazil to suspend concessions on the import of goods, only. So, Brazil requested authorization to suspend its obligations under the General Agreement on Trade in Services (GATS) and the Trade-Related Aspects of Intellectual Property Rights Agreement (TRIPS), which would permit Brazil to retaliate against services and intellectual property rights, in addition to goods from the United States.

The panel closely examined Brazil's imports of U.S. goods. The panel was willing to concede that the import of certain goods (such as capital goods, intermediate goods, inputs, books, and autos) were sufficiently sensitive that retaliation could not reasonably be applied to their import without negatively impacting the Brazilian economy and consumer. However, the panel found other goods (some medical supplies, food, arms, and other luxury items) that would provide sufficient trade flows for the imposition of the approved countermeasures. In 2007, for example,

the panel concluded that there was, at minimum, \$409.7 million of goods imported from the United States that could be reasonably subjected to the \$296.7 million of countermeasures.

Based on this, the panel permitted Brazil to retaliate only against the import of U.S. goods, unless permitted countermeasures (the amounts permitted for the prohibited subsidies *and* the actionable subsidies) exceed the amount of U.S. goods imports for that year. In that case, Brazil would be allowed to strike back against U.S. services or intellectual property rights. Both the value of countermeasure (the fixed amount for actionable subsidies and the variable amount for the prohibited subsidies) and the value of U.S. goods imported by Brazil would be recalculated each year to determine the appropriate form of retaliation.

Conclusions

The WTO's Dispute Settlement Body, which meets in September, must approve the sanctions before they can be imposed. And while this is the second largest award granted a country in the WTO's dispute settlement history, there are still some "wins" for the United States.