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## The African Cotton Initiative and WTO Agriculture Negotiations

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### Summary

In World Trade Organization (WTO) Negotiations on agriculture, a group of African countries have proposed that all subsidies for cotton be eliminated by the end of four years. The proposal also advocates compensating African cotton producing countries for revenues estimated to be lost due to cotton subsidies. The United States, which provides substantial production-related subsidies to cotton producers, agrees that cotton subsidies distort trade, but maintains that the issue should be negotiated in a comprehensive manner. Disagreement over the African cotton initiative has blocked progress on an agreement on agriculture in the current round of multilateral trade negotiations known as the Doha Development Agenda (DDA). How to tackle the question of cotton subsidies — either as a stand-alone initiative or as part of a broader agreement to reduce trade-distorting farm subsidies — will be on the agenda as DDA negotiations continue in 2004. If the initiative were agreed to as proposed, U.S. cotton producers would no longer be receiving 2002 farm bill marketing loan, loan deficiency, or counter-cyclical payments after four years. Under a U.S. alternative proposal for reduction in trade distorting subsidies, cotton producers could still receive payments under those programs but in reduced amounts. This report will be updated.

### The African Cotton Initiative

Four cotton producing African countries — Benin, Burkina Faso, Chad, and Mali — have proposed in WTO agriculture negotiations the complete elimination of trade-distorting domestic support and export subsidies for cotton.<sup>1</sup> The four countries propose an end to cotton export subsidies over three years, followed by the elimination of

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<sup>1</sup> The original proposal, WTO Negotiations on Agriculture, *Poverty Reduction: Sectoral Initiative in Favour of Cotton: Joint proposal by Benin, Burkina Faso, Chad, and Mali*, Committee on Agriculture, Special Session, TN/AG/GEN/4, May 16, 2003, was revised in WTO, General Council, *Poverty Reduction: Sectoral Initiative on Cotton: Wording of Paragraph 27 of the Revised Draft Cancun Ministerial Text: Communication from Benin*, WT/GC/W/516, October 7, 2003. These documents can be retrieved from [<http://www.wto.org>].

production-related domestic support over four years, in each case from January 1, 2005. In addition, the proposal calls for WTO members to establish a transitional financial compensation mechanism in favor of cotton-exporting developing countries affected by the subsidies. Data from the International Cotton Advisory Committee (ICAC) would be used to calculate developing country revenue losses.<sup>2</sup> Although not specifically mentioned in the Doha round negotiating mandate, cotton subsidies have been identified as a key issue to resolve before DDA negotiations can be successfully concluded.<sup>3</sup>

## **Cotton Production in West and Central Africa (WCA) and in the United States**

Cotton production is an important economic activity in WCA countries.<sup>4</sup> According to data from the United Nations Food and Agriculture Organization (FAO), cotton production accounts for 5% to 10% of the gross domestic product (GDP) in Benin, Burkina Faso, Chad, and Mali.<sup>5</sup> Cotton accounts for around 30% of total export earnings of WCA countries and more than 60% of earnings from agricultural exports. The World Bank reports that over 2 million farmers in the region produce cotton.<sup>6</sup>

Cotton production in the United States does not occupy a similarly dominant role in the total U.S. economy, but it does occupy an important place in the U.S. agricultural economy.<sup>7</sup> Cotton production accounts for just over three-hundredths of a percent (0.034%) of U.S. GDP (2002). Cotton exports account for 1.4 % of total merchandise exports and 4% of agricultural exports. Cotton production employs 173,447 people on 31,433 farms. An additional 200,000 jobs are provided by cotton ginning, marketing and transportation, and in cottonseed oil mills and textile mills. Total revenue generated by the entire sector of \$40.1 billion represents 3.8 % of GDP.<sup>8</sup>

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<sup>2</sup> ICAC is an international organization composed of 43 member governments, including the U.S. Government. It provides statistics on world cotton; serves as a clearinghouse for technical information about cotton and cotton textiles; and serves as a forum for discussion of cotton matters of international significance. Its website is [<http://www.icac.org>].

<sup>3</sup> *Statement by the Chairman of the General Council*. Doha Development Agenda: Informal Heads of Delegation Meeting, December 9, 2003. Retrieved from the Worldwide Web on December 9, 2003: [[http://www.wto.org/english/news\\_e/news03\\_e/stat\\_gc\\_chair\\_9dec03\\_e.htm](http://www.wto.org/english/news_e/news03_e/stat_gc_chair_9dec03_e.htm)].

<sup>4</sup> The WCA region includes Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Cote d'Ivoire, Mali, Senegal, and Togo. These countries share a common currency, the CFA franc, and have similarly organized cotton sectors. Other WCA cotton-producing countries that do not share the CFA currency and whose cotton sectors are organized differently include Ghana, Guinea, and Nigeria. Smaller CFA franc zone countries (Guinea Bissau and Niger) also are excluded.

<sup>5</sup> P. Fortucci, *The Contributions of Cotton to Economy and Food Security in Developing Countries*, UN Food and Agriculture Organization, June 2003.

<sup>6</sup> *World Bank, Cotton Policy Brief*: a quarterly newsletter of the World Bank on cotton sector policy reform and implementation issues, June 1999.

<sup>7</sup> Basic data on cotton is available at [<http://www.ers.usda.gov/Briefing/Cotton/>].

<sup>8</sup> U.S. Census data reported by the National Cotton Council of America in *U.S. Cotton Production: 2002 Crop Year* at [<http://www.cotton.org/econ/world/detail.cfm?year=2002>].

The United States is the second largest producer of cotton, but is the world's largest exporter. Marketing year 2003 exports are estimated at 2.9 million metric tons and account for 41% of world cotton exports. The WCA region is the third largest producer, accounting for 5% of world cotton production and the second largest exporter, accounting for 12% of world cotton exports. Uzbekistan is the third largest exporter with about 10% of world exports. China, the world's largest cotton producer, is also the world's largest importer of raw cotton.<sup>9</sup>

WCA countries are low cost producers of cotton.<sup>10</sup> For example, in 2001, the average cost of production in Benin, one of the four sponsors of the cotton initiative, was 31 cents per pound. In the United States, the national average cost of production was 68 cents per pound in 2001.

## The Economic Rationale for the African Initiative

The economic rationale for the African cotton initiative is based in part on an analysis conducted by ICAC which estimates that cotton producers in developing countries (not just Africa) face annual losses of about \$9.5 billion as a result of subsidies that other countries provide their cotton farmers.<sup>11</sup> Losses of this magnitude, according to ICAC, are the result of the excess production stimulated by subsidies that depress world cotton prices. The ICAC study notes that world prices for cotton at 42 cents per pound (in 2000/2001) were at their lowest level in 30 years. Low cotton prices, according to ICAC, particularly affect revenues earned by some of the poorest African countries; while producers in subsidizing countries are shielded from price declines by subsidies.

ICAC points out that the United States provides the largest amount of subsidies to its cotton producers, which it estimated at \$2.3 billion in 2001/2002. Other countries' subsidies in 2001/02 included China (\$1.2 billion), European Union (EU) countries Greece and Spain (\$716 million), Turkey (\$59 million), Brazil (\$50 million), and Egypt (\$29 million). ICAC simulated the reduction in cotton production if U.S. subsidies were eliminated. According to the simulation, without subsidies, U.S. cotton production in 1999/2000 would have been 900,000 tons lower than actual production in that year, 700,000 tons less than actual production in 2000/2001, and 1.4 million tons less than actual in 2001/2002.

The simulated removal of subsidies resulting in lower production, leads to higher prices in the short term. The simulated decline in U.S. production results in average international prices per pound of cotton 6 cents higher than realized in 1999/00, 12 cents higher than in 2000/01 and 22 cents higher than in 2001/02. Higher prices would reduce the demand for cotton. Thus the initial price increases would be lowered by 1, 2, and 6

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<sup>9</sup> USDA. Foreign Agricultural Service, *Cotton: World Markets and Trade*, 2003.

<sup>10</sup> ICAC, *Survey of the Cost of Production of Raw Cotton, A Report by the Technical Information Section of ICAC*, September 2001. While noting that its data is the only source of information on the cost of production of raw cotton at the international level, ICAC also notes that "the data must be used carefully. Differences in production practices, variations in the input supply system ....make comparisons difficult among countries."

<sup>11</sup> ICAC, *Production and Trade Policies Affecting the Cotton Industry*, Washington, DC, July 2002.

cents per pound respectively in the three marketing years simulated. Initial price increases also would be offset by shifting world production to non-subsidizing countries in the medium and long terms. Overall, however, the ICAC study says that the removal of cotton subsidies would have had a net positive effect on the world price of cotton by 3 cents in 1999/2000, 6 cents in 2000/01, and 11 cents in 2001/02.

U.S. and other country subsidies are not the only factor depressing world cotton prices. ICAC says that weak consumer demand resulting from the recent economic slowdown and continuing competition from synthetic fibers are preventing world cotton consumption from more rapid growth. In addition, says ICAC, improved technology, the strong U.S. dollar, and the expansion of cotton production into new areas contributed to the increase in world cotton supply in 2001.

A recent World Bank report used results from the ICAC study to illustrate the effect of U.S. and other countries' subsidies on cotton producers in the WCA region.<sup>12</sup> According to the World Bank Report, ICAC's estimate of a 11 cent per pound increase in the net average world price for cotton (in 2001/2002) would translate into revenue gains of \$250 million a year for WCA farmers. Oxfam, a British non-governmental organization, also contributed to the debate over the impact of cotton subsidies, with publication of a report that estimated revenue losses to African farmers from U.S. cotton subsidies.<sup>13</sup> Both the World Bank and Oxfam have played a major role in mobilizing public opinion in support of the African cotton initiative.

## **The U.S. Response to the Cotton Initiative**

The U.S. responded to the cotton initiative by proposing that cotton be included in a comprehensive negotiated agreement to cut subsidies and tariffs on all farm products and eliminate tariffs and non-tariff barriers on manufactured goods, including textiles.<sup>14</sup> The U.S. Trade Representative (USTR) maintains that the problems affecting cotton extend beyond the issue of subsidies and include factors such as competition by synthetic fibers, the slowdown in world economic growth, and higher yields due to favorable weather conditions. USTR cites many barriers that limit market opportunities and distort trade of cotton: trade distorting domestic support applied by the United States, the European Union, China and some developing countries; high average allowed tariffs for cotton and textiles and clothing; non-tariff barriers such as non-transparent customs procedures, difficult and costly marking and labeling requirements, and burdensome testing methods; and industrial policies related to man-made fibers that distort the market and displace sales of cotton and cotton products. As an alternative to the African sectoral

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<sup>12</sup> *Cotton Sector Strategies in West and Central Africa* by Ousmane Badiane, Dhaneshwar Ghura, Louis Goreux and Paul Masson, World Bank Policy Research Working Paper 2867, July 2002, which draws on a report prepared by Louis Goreux, consultant to the World Bank, entitled *Damage Caused to the Cotton Industry in West and Central Africa Through Payments of Subsidies by Industrialized Countries*, July 2002.

<sup>13</sup> Oxfam, *Cultivating Poverty: The Impact of U.S. Cotton Subsidies on Africa*, Oxfam Briefing Paper 30, 2002.

<sup>14</sup> See *Remarks on African Cotton Initiative*, Ambassador Josette Sheeran Shiner, Fifth World Trade Organization Ministerial, September 10, 2003, available at [<http://www.ustrade-wto.gov/tr0911shiner.html>].

approach, the United States proposed a comprehensive initiative that would address four areas: subsidies for cotton and man-made fibers; tariffs on fiber, textiles, and clothing; non-tariff barriers; and other barriers such as state monopolies, special tax advantages, and export requirements.

The National Cotton Council of America (NCC), an organization that represents producers, ginner, warehouse, merchant, crusher, cooperative and textile manufacturers, allied itself with the USTR proposal to link WTO negotiations on cotton with textile trade negotiations.<sup>15</sup> A bipartisan group of U.S. Senators from cotton-producing states expressed their opposition to the African cotton initiative in a letter to the U.S. Trade Representative.<sup>16</sup> The Senators stated that “the current round of multilateral trade negotiations offers an opportunity to increase market access and further discipline trade distorting domestic support and export subsidies....A sectoral initiative focusing specifically on the U.S. cotton program is counterproductive to U.S. cotton’s interest and distracts from multilateral reform of agricultural trade.”

## Implications for U.S. Cotton Programs

Adoption of a stand-alone sectoral initiative, as proposed by the African countries, could mean that cotton producers would, after four years, no longer be receiving payments under 2002 farm bill programs that are linked to production, namely marketing loan assistance and loan deficiency payments.<sup>17</sup> Cotton producers also could become ineligible to receive payments under the 2002 farm bill’s new counter-cyclical payments (CCP) program. CCP payments are linked to the level of commodity prices. Direct payments, also authorized by the 2002 farm bill, would not be affected if the initiative were adopted because they are not production related. In FY2002, cotton producers received \$721 million in loan deficiency payments. CCP payments were included in the 2002 farm bill; estimated CCP payments for cotton in FY2003 total \$1.247 billion.<sup>18</sup> Direct payments in FY2003 are estimated to be \$428 million. Credit guarantees for cotton exports, an estimated \$234 million in FY2002, also could be affected under a stand-alone initiative as proposed by the Africans.<sup>19</sup>

Adoption of the U.S. proposal to reduce cotton subsidies as part of a comprehensive approach to reducing trade-distorting domestic support, also could have substantial, if less drastic, consequences for cotton. The most recent U.S. proposal for WTO agriculture

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<sup>15</sup> National Cotton Council, *USTR Proposal on Trade Distortion Discussions Much Needed*, Press Release, September 11, 2003.

<sup>16</sup> Letter from Senators Cochran, Lincoln, and Chambliss to USTR Ambassador Robert B. Zoellick, dated September 8, 2003, available at [<http://www.cotton.org/gov/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=16220>].

<sup>17</sup> For a basic description of these programs see CRS electronic briefing book page on *Commodity Programs* at [<http://www.congress.gov/brbk/html/ebagr8.html>].

<sup>18</sup> Payment data are from USDA *2004 Budget, Explanatory Notes for Committee on Appropriations*, Volume 2, pp. 19-19 to 19-21, February 2003.

<sup>19</sup> CRS Report RS20858, *Agricultural Export Subsidies, Export Credits, and the World Trade Organization*, March 27, 2001, discusses the extent to which export credit guarantees subsidize agricultural exports.

negotiations is contained in a letter from the U.S. Trade Representative to WTO members.<sup>20</sup> In the letter, the USTR affirms that it is the “objective of the United States to achieve substantial cuts in trade-distorting domestic support for agricultural products, including cotton; the elimination of export subsidies for cotton and all other agricultural products; and substantial improvements in market access for cotton, cotton products, and other agricultural goods.” Under this latest formulation of the U.S. proposal, trade-distorting programs like marketing loan gains/loan deficiency payments would be reduced but not eliminated. The U.S. proposal, which recognizes a subsidy element in export credit programs, also could result in changes in U.S. export credit guarantees for cotton and other products.

While elimination or reduction of U.S. cotton subsidies could benefit farmers in African and other low-cost producers of cotton (e.g., Australia), the economic effects in the United States could be both positive and negative. U.S. consumers could benefit from lower prices for products made from cotton. (U.S. tariffs and quotas on textiles would also have to be liberalized for U.S. consumers to receive much benefit from cotton subsidy reduction or elimination.) Taxpayers could benefit from not having to pay for support of cotton producers. However, cotton producers, industries that supply inputs to cotton production, and rural communities could be adversely affected. Workers in ginning, transportation and marketing, warehousing, and cotton seed crushing could all be adversely affected. Those affected could be expected to oppose the elimination of subsidies and/or demand adjustment assistance to compensate for adverse impacts of subsidy elimination.

## **Status of the Issue**

The African cotton initiative remains on the WTO negotiating agenda and is an issue that appears to be blocking the completion of the Doha round. The four African sponsors of the proposal, other African countries, and other developing countries continue to insist on a separate, sectoral approach to the cotton subsidy issue. The United States, on the other hand, continues to insist on including cotton subsidies in a broader negotiating approach. U.S. cotton subsidies also are being challenged in WTO dispute settlement where Brazil is arguing that the United States has exceeded its subsidy reduction commitments for cotton.<sup>21</sup> If Brazil wins this dispute, the United States either would be obliged to alter its cotton subsidy programs or accept the imposition of retaliatory tariffs by Brazil on some of its products. In 2004, interested Members of Congress will be closely monitoring the WTO agriculture negotiations, the African cotton initiative, and the WTO cotton dispute.

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<sup>20</sup> The letter is at [<http://www.ictsd.org/ministerial/cancun/docs/Zoellick-letter.pdf>].

<sup>21</sup> Information on the Brazil-U.S. cotton dispute (dispute no. DS267) is available at [[http://www.wto.org/english/tratop\\_e/dispu\\_e/dispu\\_subjects\\_index\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/dispu_subjects_index_e.htm)]. Select subject entry “cotton.”

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