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The WTO's Cotton Crisis and the Crisis in Commodities

Summary

The major disagreements expressed during the World Trade Organization's agriculture negotiations are considered to be the primary reason why the Doha Round of negotiations broke down. Within the agriculture talks, addressing the current crisis of low cotton prices had consistently been pushed to center stage. If the Doha Round is to continue, the concerns of cotton producing countries will have to be addressed. This short analysis outlines the Cotton Initiative tabled by Benin, Burkina Faso, Chad and Mali (the Cotton 4) and discusses some of the issues it raises. It considers some of the factors affecting cotton prices that fall outside the WTO's current purview, particularly the competition cotton faces from oil-based and subsidized fibers. And it looks at the possibility of addressing the concerns raised by the Cotton 4 in the context of the wider African Group proposal on commodities.

Introduction

The crisis in the Doha round, apparent at the July 24 suspension of negotiations, has been depicted by much of the press as a disagreement over numbers and not fundamental concepts. WTO Director General Pascal Lamy spent July trying to get the most influential WTO members to agree on numerical targets for tariff reductions in non-agricultural and agricultural market access and in subsidy support for agriculture. Included in the quest for agreed numbers is a reduction in subsidies, used disproportionately by the U.S., to grow and export cotton. One indication of the lack of U.S. political support for the negotiations is the insistence of Senator Saxby Chambliss, chair of the U.S. Senate Committee on Agriculture, that U.S. negotiators make no concessions on cotton.[1]

What prompted Senator Chambliss' fierce defense of U.S. cotton subsidies is the "Sectoral Initiative in Favour of Cotton," (Cotton Initiative) first presented in 2003 by the Cotton 4.[2] At the WTO Ministerials in Cancún, Mexico and in Hong Kong, the Cotton 4 proposed to reduce agricultural export subsidies and trade distorting domestic support to a greater degree and more rapidly than what may be agreed to in the Agreement on Agriculture (AoA) negotiations. The diplomatic initiative was supported by petitions signed by thousands of West African cotton farmers and presented to the Chair of the Ministerial in Cancún.[3] The U.S. has given no indication it will support the Cotton Initiative and has argued that its domestic support programs have neither depressed prices nor hurt foreign competitors.[4]

The latest Cotton 4 proposal (TN/AG/SCC/GEN/4: March 1, 2006) calls for the elimination of all Aggregate Measure of Support (AMS) payments for cotton by 2010 at the latest. The U.S. AoA proposal of October 10, 2005, still the official U.S. negotiating position, suggests instead the possible elimination of cotton AMS, but only simultaneously with all other AMS, only if a number of conditions are met, and only by 2022.[5]

The U.S. can well afford to stall. U.S. demands for greater agricultural market access concessions, including an average 66 percent cut on developing countries' industrial tariffs,[6] before it agrees to subsidy reductions represent a pseudo-trade-off. It has already obtained many of those market access concessions in bilateral trade and investment negotiations. Moreover, there is no support in the U.S. Congress to give the U.S. Trade Representative the mandate to reduce subsidies to the degree demanded by other WTO members.

Recent studies based on the expected outcome from the agricultural negotiations if the Doha Round were to continue foresee economic losses for most developing countries, particularly for African countries, by 2015, the previously stated end date for final implementation of the Doha Round agreements.[7] More specifically, the AoA framework does not provide the means to increase cotton export revenues nearly enough to reverse the catastrophic recent decline in cotton prices. The International Monetary Fund reports that inflation adjusted export prices for raw cotton exports fell by about 45 percent between 1980 and 2000.[8] Removal of all subsidies and tariff barriers, an outcome advocated by some free traders but never expected from the Doha AoA negotiations, would increase cotton export prices by less than 13 percent by 2014, according to World Bank research cited in the Cotton 4 proposal (paragraph 12). Since removing all subsidies and tariffs is not part of the Doha negotiations, the actual price increase would likely fall far short of 13 percent.

Why such limited gains from the Doha agenda for cotton? Because the Doha negotiations did not deal with three cotton relevant issues that remain outside the core AoA framework of market access, export competition and domestic support.

1. Cotton and other natural fibers have lost market share to oil-derived textiles. Oil remains undisciplined by WTO rules, except indirectly insofar as oil is affected by WTO commitments in energy services, because members refuse to accept open markets for such a sensitive product. The subsidies that give oil-derived textiles their competitive advantage continue unchecked.

2. Even assuming cotton regained competitive parity as a result of rising oil prices, the lack of any international supply or production management mechanism for cotton will continue to result in structural oversupply and consequently in low cotton prices. Low prices tend to encourage producers to use environmentally unsustainable methods to increase cotton planting, hoping to increase revenues through increased export volume. Yet recent experience shows this strategy does not work. In the last two decades, West and Central African (WCA) countries quintupled their cotton production,[9] and yet their cotton export revenues stagnated or fell. The U.S. offer of US$7 million to help WCA cotton producers increase their production, particularly through the adoption of genetically engineered cotton varieties, has been coolly received.[10] The AoA framework is not equipped to address the vicious circle of structural oversupply, depressed prices and environmentally unsustainable increases in cotton exports.

3. Third, the AoA fails to discipline agricultural export dumping, which favors the companies benefiting from rich country cotton subsidies. Not only are subsidies likely to be maintained at current levels, even if governments have to change how they categorize and report ("notify") them to the WTO, but other aspects of dumping, including unchecked oligopolistic power in commodity markets, are not even up for discussion. Just three firms, Allenberg Cotton, Cargill Cotton and Dunavant Enterprises control 85-90 percent of the global cotton trade.[11]

Summary of the Cotton Initiative

One part of the Initiative operates within the Doha negotiating framework, looking at market access, domestic subsidies and export support. This part of the Initiative is particularly focused on trade distorting domestic subsidies, AMS payments chief among them. The other part, assumes a delay in the implementation of AMS reductions, and proposes a compensation mechanism for African cotton-producing countries "until such time as internal and external reforms bear fruit" (paragraph 23).

In the Hong Kong WTO Ministerial Declaration of December 2005, WTO members agreed that the reduction in trade distorting domestic subsidies for cotton should be "more ambitious" than the level of proposed subsidy reductions overall. To reduce AMS for cotton more "ambitiously," the Cotton 4 proposal of March 2006 contains a reduction formula for cotton that includes a "correction co-efficient" applied to the general agreed AMS reduction, (TN/AG/SCC/GEN/4, paragraphs 5-7). The less ambitious the overall reduction, the greater the correction sought by the Cotton 4. So if WTO members agree to the highly qualified U.S. proposal of a 60 percent cut in AMS over eight years, the correction coefficient would result in an 82.2 percent cut in trade distorting domestic support to cotton (paragraph 8). If AMS were eliminated altogether, no correction would be needed.

The Cotton 4 also propose that AMS reductions for cotton be completed in one third of the time agreed for overall reductions, so by 2010 instead of 2015. Furthermore, they propose the ceiling for subsidies "considered to be less trade distorting," (the Blue Box) be "one third of the general `blue' ceiling" for cotton (paragraph 20). If the U.S. proposal of October 2005 had been accepted, Blue Box subsidies would be limited to 2.5 percent of the total value of agricultural production, or about US $5 billion for the United States.[12] The Cotton 4 proposal, if accepted, would cut that limit to about US$1.7 billion.

According to the Initiative, WTO member countries should agree "to the principle of creating a safety net for poor cotton-producing countries in Africa" and also agree to have their World Bank country representatives meet to arrange financing for a safety net for cotton growers (paragraph 25). But agriculture negotiations chair Ambassador Crawford Falconer's draft modalities compilation (WTO reference is JOB (06)/199 dated June 22, 2006) makes no mention of a "safety net" or mechanism for financing it, presumably because of developed country opposition to the proposal. To date, compensation for anticipated African cotton export revenues unrealized during the implementation process of the Initiative are not part of the Doha negotiations. The only part of the Initiative Ambassador Falconer sees support to negotiate is the reduction of cotton subsidies.

Subsidy cuts and potential cotton prices

What can the Cotton 4 hope for from the reduction of tariffs, the elimination of export subsidies and reductions in trade-distorting domestic support? Divergent estimates reflect different policy assumptions, data, and time frames used by different models.[13] One United Nations Food and Agriculture Organization (FAO) study estimated that world cotton export prices would increase about 3-4 percent after the elimination of import tariffs and trade distorting support over the "long run."[14] Simple averaging of data in an Agricultural Policy Analysis Center study results in a U.S. average annual price increase for cotton of about ten percent over 2003-2011, following the elimination of U.S. government marketing loan payments, direct payments (decoupled from production) and counter-cyclical (price responsive) program payments, when compared to a 2003 baseline scenario of continuing the support system set in the 2002 U.S. farm bill.[15] A study by the International Cotton Advisory Council estimates that rich country export subsidies and domestic support to cotton in 1999 depressed prices by 20 percent, resulting in $300 million in lost value for African cotton exporters.[16]

However, no matter what global cotton price increase might result from AMS reduction or elimination, it will only partially counteract the huge amount of cotton dumping that unfairly competes with African cotton exports. For example, following removal of the last U.S. supply management and related policy tools in the 1996 Farm Bill, U.S. cotton was exported, on average, at prices 48.4 percent below the cost of production between 1997-2003.[17] In other words, nearly half the U.S. export price of cotton was a dumped price. (The U.S. share of global cotton exports jumped from 17 percent to 42 percent between 1998 and 2003.[18]) Clearly, cotton dumping is a far bigger problem than can be remedied by the elimination of AMS payments for cotton alone.

Beyond the WTO's purview? Oil subsidies and cotton

Cotton prices are affected by more factors than agricultural subsidies. At the WTO ministerial in Cancún, Mexico, then European Union trade commissioner Pascal Lamy identified a crucial component of a work program for the WTO cotton subcommittee— "the price of oil (which influences the price of synthetics)."[19] Cotton competes against oil-derived synthetic textiles, particularly polyester. As an illustration of the relationship to polyester, the general downward trend of cotton prices was interrupted only in 1973-74, when a sharp increase in the price of oil increased costs for textile manufacturers.[20]

According to the International Cotton Advisory Council, the inflation-adjusted price for a kilogram of raw cotton fell from US$2.81 in 1960 to $1.04 in 2002. However, the inflation-adjusted price for oil-derived polyester fell more steeply, from $12.01 per kilogram to $1.37.[21] Econometric analysis of this price competition, taking into account the massive shift from cotton to synthetic fibers, has concluded, "cotton prices follow polyester prices."[22] Cotton's portion in global fiber consumption has fallen from 68.3 percent in 1960 to 39.7 percent in 2002. Meanwhile, chemically derived textiles, mostly oil-based, have increased their share of consumption from 21.8 percent in 1960 to 57.7 percent in 2002.[23]

In Cancún, the United States talked of a "separate comprehensive sectoral initiative that targets distortion in the entire value chain of supply affecting cotton prices. This would start with raw cotton, and include man-made fibers, textile and clothing trade."[24] Perhaps not surprisingly, the U.S. did not develop this idea into a formal proposal. It is all but inconceivable that the U.S. military and other constituencies would allow WTO negotiations to eliminate oil production subsidies. Even if WTO talks were to continue, a subsidies-based WTO natural and man-made fibers initiative seems highly unlikely.

Cotton as a sustainable source of export revenues

Even if world cotton prices were to rise 45 percent to their 1980, pre-trade liberalization levels, for several cotton exporting countries the environmental costs of cotton production are so great that diversification into other crops, and to non-agricultural production needs to be considered. In Benin, where 80 percent of export revenues derive from cotton, the costs of massive deforestation and soil exhaustion in land cleared for cotton planting have yet to be calculated, let alone paid for by meager cotton export revenues.[25] Over the last three decades, proposals for diversification—to say nothing of internalizing the costs of agro-environmental remediation in cotton prices—have not been well supported by donor countries.

There has also been a lack of political will to treat the commodities price and rural development crisis comprehensively and ambitiously, most recently evidenced by the lack of donor interest in financing UNCTAD's decision in July 2004 to establish the International Task Force in Commodities.[26] Perhaps the WTO collapse will reignite interest in the Task Force and it will get the funding it needs to move forward.

This political failure is not merely a by-product of the antipathy of some developed countries towards UNCTAD. Thus far, African proposals for a comprehensive solution to the commodity crisis in general have not received much support either, particularly from developed country WTO members. The latest of these proposals, presented by the African Group of 41 countries on June 7 2006 (TN/AG/GEN/18), cites various provisions in the General Agreement on Tariffs and Trade that could establish a framework for negotiations to achieve the 1994 GATT objective of "stable, equitable and remunerative" commodity prices.

The African Group proposal for commodity export dependent WTO members

The Institute for Agriculture and Trade Policy welcomed the Africa Group's commodity proposal as a "serious chance to redeem" the failure of the Doha negotiations to deliver the promised development agenda announced at their launch in November 2001.[27] The African Group proposal calls for negotiations on four topics:

1. The elimination of higher tariffs on processed commodities ("tariff escalation") to enable value-added exports from developing countries.
2. Agreement on international systems of supply management for commodities as authorized by the 1994 GATT to achieve stable and remunerative commodity prices.
3. Agreement to allow WTO members to apply export taxes and restrictions for supply management and food security goals.
4. Agreement on a framework for negotiating "the elimination of non-tariff measures," such as food standards and packaging requirements that affect trade in commodities.

Topics two and three are interpreted in Annex M of Ambassador Falconer's draft modalities compilation of June 22 and thus are part of what Members may negotiate if the Round continues. Since reducing tariff escalation is a long-standing demand from many WTO members, Ambassador Crawford puts the topic in "Other Issues" (pp. 6-7), rather than in Annex M.

The fourth issue raised by the African Group, the proposal to eliminate non-tariff measures affecting trade in commodities, is not reflected in Ambassador Falconer's draft text. Non-tariff measures that affect the cotton trade include quality grading, and invasive species that may come with cotton or its packaging materials. Such non-tariff measures are negotiated in the WTO committees on food safety, plant and animal health (the SPS Committee) and the Committee on Technical Barriers to Trade (TBT Committee). The implementation and enforcement of non-tariff measures have among their objectives the protection of public health and the environment; their elimination is neither practical nor desirable.

However, the proliferation of standards, the often high cost of implementing them, and the low revenues generated by developing country commodity exports to pay for standards implementation and enforcement have made if difficult for most developing country exporters to meet importing country non-tariff requirements. Fulfilling these requirements is necessary to benefit from market access opportunities that have been negotiated at the great cost of offering lucrative concessions to developed country Members. Instead of proposing to eliminate non-tariff measures, the African Group could modify its technical and financial assistance proposal, represented in Ambassador Falconer's June 29 correction to the draft modalities text, to require the inclusion of funds for training and infrastructure to meet the non-tariff requirements of importing Members. As advocated by Nobel Laureate Joseph Stiglitz, WTO technical and financial assistance commitments should be binding and enforceable.[28]

The Cotton Initiative and "Commodity Arrangements"

The current suspension of negotiations is an opportunity for WTO members to consider AoA negotiating proposals outside the market access/export competition/domestic support structure. WTO members could revise the current AoA negotiating framework that is projected to benefit only a few developing countries while harming many more.

The commodities proposal offers more policy tools to address the commodities crisis, including cotton, than does the Cotton Initiative's reliance on cuts to trade distorting government support payments for cotton. For example, under the framework of "Commodities Arrangements" a supply and production management mechanism for oil-derived fibers and natural fibers could be jointly agreed and implemented, so that chemically derived fiber manufacturers would not ruin cotton producers in a race to the lowest textile export price. Such a framework also could be applied to new products, such as nanotechnology's Cotton Touch, that aim to displace cotton.[29] If there is no agreement to implement any aspect of the Cotton Initiative, the Cotton 4 could seek to make cotton the first subject of economic simulation studies under "Commodities Arrangements" negotiations.

While the failings of past attempts to manage commodities at the international level need to be fully understood, so should the shortcomings of relying on the market alone to send the right signals to producers. For example, the removal of supply management mechanisms and related policy tools in the 1996 U.S. Farm Bill depressed national average farmgate prices for row crops, including cotton, by more than 40 percent by 2002.[30] At the same time, the policy reforms created huge oversupply "managed" by a dramatic increase in U.S. agricultural export dumping from 1997 to 2003.[31] Surely, WTO Members do not wish to perpetuate such unfair trading outcomes, yet neither the AoA nor the current negotiations address these issues.

Conclusion: The need for a new AoA framework

U.S. negotiators' claim the Cotton Initiative cannot be considered until there is an agreement on the general terms and numbers of AoA tariff and domestic support reductions[32] is contradicted by the negotiating practices of other WTO agreements. Developed countries are pressuring developing countries to make sub-sectoral service market access commitments in advance of agreement on what rules will apply to all service industries in the General Agreement on Trade in Services (GATS) negotiations. Similarly, in the Non-Agricultural Market Access (NAMA) negotiations, proposals have been made by U.S. industry lobbyists to advance the negotiations on a sub-sectoral basis.[33] There is no reason why a reference paper on cotton for the AoA negotiations could not serve as a model for a "Commodity Arrangements" negotiation, just as the financial services reference paper, now annexed to GATS, served to advance the broader GATS negotiations.

If WTO members decide to prioritize negotiations on "Commodities Arrangements," they will still need to find the political will to prevent the circumvention and/or non-implementation of the new rules by transnational agribusinesses that engage in export dumping. Litigation against violations of WTO subsidy rules, in lieu of rules to directly discipline agricultural export dumping, is an expensive privilege that few WTO members can afford. Preferable and less costly would be the prevention of dumping through notification of cost of production and export price factors in an agreed formula to determine whether dumping existed and how it might be disciplined in an administrative law procedure. During a "period of reflection," WTO members could propose such a formula and other means to prevent and discipline dumping. "Commodity arrangements" negotiations targeted to benefit commodity dependent exporting countries, particularly least developed countries, combined with tough export dumping disciplines, could result in more export revenue, employment and rural development benefits for the Cotton 4 than the dismal results forecast for an uncertain Doha Round.

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