

TRADE ISSUES FACING THE U.S. COTTON INDUSTRY

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Trade issues framed a major part of the Council's activities in 2003 and will continue as a Council focal point in the foreseeable future. As I discuss these events and issues I think it is important to recall that the National Cotton Council will evaluate trade agreements as to their capacity to serve the interests of the entire U.S. cotton industry. We work to ensure that both the administration and Congress understand the issues affecting cotton and endeavor to influence the specific form of proposed agreements to reflect the U.S. cotton industry's concerns.

Members of the World Trade Organization (WTO) continue to seek further reductions in trade distorting practices affecting agriculture. This round of talks, known as the Doha Round, is an attempt to reach further agreements to expand world trade, as calendar 2005 essentially marks the completion of the Uruguay Round commitments that were initiated in 1994. The Bush administration has crafted a Central American Free Trade Agreement, known as CAFTA, and details of the proposal are still unfolding. We should expect full disclosure of the proposed CAFTA agreement in the next several weeks. The Office of the U.S. Trade Representative (USTR) is working on a Free Trade Agreement of the Americas, to link to the entire Western Hemisphere in an economic fashion similar to the U.S.-Mexican-Canadian arrangement known as NAFTA.

U.S. Trade Ambassador Robert Zoellick has announced numerous bilateral trade initiatives with countries across the globe. These free trade agreements (FTAs) have been initiated for a variety of reasons. In some of these negotiations, agriculture and textile issues are quite limited by the very nature of the economy of the participating country. While in other cases a free trade agreement is considerably more complicated. Lastly, I want to briefly review the situation associated with the ongoing WTO dispute stemming from a challenge of U.S. agricultural policies by Brazil.

World Trade Organization

Part of the conclusion of the Uruguay Round of world trade negotiations was an agreement to eventually initiate another round of negotiations in an effort to further expand world trade opportunities. This latest round of talks is known as the Doha Round. A scheduled meeting of trade ministers to the WTO was held in Cancun, Mexico in September 2003, as a sort of mid-term review of the negotiations. The meeting concluded with no progress and was generally known as the Cancun Collapse. The Cancun meeting saw Brazil, India and China attempt to exert leadership of the "less developed countries" to oppose initiatives of the developed countries. Specifically, a group of 21 developing countries called for no further increases in access to their domestic markets or other significant changes in their domestic practices while calling for developed economies to completely eliminate quotas and tariffs and to dramatically reduce their domestic agricultural programs.

Much of the world saw the difficulties with the trade talks with a substantially different perspective than many in the United States. The cover of the Economist reflected a view that the developed countries were going to get their way or walk away. They were insistent on negotiating from their texts; they were unwilling to make any additions to their world trade talk agenda. Others expressed support for developing countries saying that it was time for the developed world to relinquish control of the trade talk agenda.

In fact, the many undercurrents of tradeoffs and compromises for support on particular issues make the true tension far different from a simple developed versus less developed country debate. Ever since the United States first proposed an end to all agricultural subsidization way back in 1987, the European Union and the United States have each attempted to leverage developing countries against the other's agenda. That attempt to use the developing countries as leverage leads to a lot of behind the scenes maneuvering and tends to give developing countries a distorted image of their influence within the WTO.

The African cotton initiative is a case in point. In mid-summer, four West African Countries floated a proposal within the WTO seeking the immediate elimination of the U.S. and E.U. cotton programs and seeking compensatory payments totaling about \$1 billion. The proposal should have been discarded immediately. Instead, the WTO Chairman's agenda for the Cancun talks included a separate, stand-alone cotton initiative, based on the West African countries' stated concerns and became a flashpoint for the developed versus developing world headlines. How did such a counter-productive proposal get so far?

Undoubtedly, the African initiative was encouraged by European interests, primarily as a way to pressure the United States. The initiative itself was primarily the work of Oxfam, an international aid organization that receives heavy funding from some European governments. Oxfam waged an effective campaign of misinformation attacking the U.S. cotton program -- based primarily on analysis from a critically flawed report issued by the International Cotton Advisory Committee in 2002. The United States, not wishing to unduly offend developing countries, did not initially condemn the African proposal. The result was a "cotton ini-

tiative” in General Council Chairman Castillo’s agenda that, if acted upon, would have singled out the U.S. cotton program for elimination - separate from the general agricultural talks being held within the WTO. Other press outlets picked up the football, with the *New York Times* making the U.S. cotton program a favorite target of its editorial pages.

The Council was deeply concerned by the inclusion of the "cotton initiative" in the Chairman’s agenda and expressed our desire to USTR that cotton not be singled out from general agricultural discussions. With the Council’s ongoing communication to Congress regarding the preparation for the Cancun talks, Senators Cochran, Lincoln, and Chambliss echoed the Council’s position with letters to USTR urging rejection of the initiative isolating cotton.

The National Cotton Council distributed materials to Congressional offices and other agricultural interest organizations and had several sessions with the agricultural negotiators of USTR to ensure that USTR and other agricultural interests had a clear understanding of the many forces at work in the global cotton and textile markets.

In Cancun, the US countered the cotton specific initiative with a broader proposal to examine all trade distorting aspects of fiber production and trade as well as production and trade in textiles and apparel. The USTR correctly established that cotton production and trade issues are only a small component of the total array of policies and programs affecting fiber producers across the globe. Many countries with significant man-made production facilities and complex domestic textile production support programs (India, Pakistan, and China to name a few) applauded the African “cotton initiative” and but suddenly had little to say regarding the broader, more comprehensive, US counter proposal.

As the Cancun experience demonstrates, every segment of the U.S. cotton industry can be directly affected by discussions within the world trade organization. While the Cancun talks failed to realize progress, and our industry breathed a collective sigh of temporary relief, the Chairman of the WTO is hard at work trying to restart trade talks with a new agenda. Fortunately, the “cotton initiative” is no longer part of the new agenda. Neither is the US counter proposal for comprehensive talks on fiber and textile production and trade.

While there has been something of a recent calm on the editorial front, if Chairman Castillo is successful in scheduling another ministerial round of talks for the WTO, then we should expect a renewal of the general media’s interest in our program.

The National Cotton Council has worked continuously to dispel the errors and misrepresentations that are so blatant in editorials appearing in the *New York Times*, *Wall Street Journal*, *Washington Post* and other media. As Chairman Greene noted earlier this morning, a number of industry members have been willing to step out, at the risk of personal scrutiny, to set the record straight for U.S. agriculture in general and cotton in particular. Our complaint is not with the agricultural media. They have extended every effort to put agriculture’s story in front of their readers, listeners and viewers.

There were other reasons for the difficulties in Cancun, but cotton had an undeserved, stand-out role there. This industry has repeatedly taken the position that it is willing to agree to fair rules governing agricultural program and will join other commodities and other countries in agreeing to reductions in agricultural support. But we will not stand by while we are unilaterally and unfairly targeted.

Central American Free Trade Agreement

The Central American Free Trade Agreement is nearing the final stages of formation. The details of the proposed agreement should be available in the very near future. This agreement was hailed as possessing the potential to offset the damage to the U.S. textile sector from soaring Asian and Chinese textile and apparel imports. The rules of origin governing which products are granted preferential treatment in trade are critical to ensuring there are gains from the agreement.

The agricultural portion of the agreement was largely uncontroversial for cotton, but U.S. sugar sought exclusion from the agreement. Negotiators have reported that virtually all tariffs disappear within 15 years for agricultural products (which includes cotton coming to the U.S.) with some products enjoying immediate duty-free access. The agreement includes sugar, but instead of eliminating sugar quotas, it provides for special growth in the WTO sugar TRQ for Central American countries. Some other agricultural products identified as sensitive will have special safeguard mechanisms that would trigger if import surges exceed 130% of the TRQ.

The Council has worked with many textile organizations to frame a CAFTA agreement that would benefit participating countries but not 3rd countries. It has been the position of the Council that only the negotiating parties should benefit from any agreement. The textile industry in Central America is currently dominated by cut-and-sew operations with some knitting plants. The region has little yarn spinning activity. Proposals that offer large trade preference levels (TPLs) and loose short supply provisions essentially just grant countries such as China an easy duty-free pass through of textile products to the U.S. market.

Gaylon Booker, former Council President and CEO and now trade consultant for the Council, has worked tirelessly for the past year to bring a unified textile voice to the CAFTA negotiations. The central focus of the effort has been to find a set of rules of origin that permit U.S. cotton textile product to move to Central America for further processing and ultimately land on U.S. retail shelves competitively with Asian sourced products.

Another facet of the rule of origin debate was whether textile products originating in Mexico and then further processed in Central America would receive duty-free access to the U.S. market. This new wrinkle in rules-of-origin has been called "cumulation." If Canada concludes trade agreements with the Central Americans then the cumulation would extend to Canadian textile products as well. The Council, working with 16 textile organizations, got 169 members of Congress to sign a letter to President Bush urging the President to bring a CAFTA agreement to Congress that would not include TPLs or cumulation.

Representatives of U.S. textile firms, the National Cotton Council, USTR, and Central American textile manufacturers have met several times to discuss possible measures to address concerns of both the U.S. and Central American textile firms.

According to press reports, the proposed CAFTA agreement has some TPLs and provides for some cumulation. The American Textile Manufacturers' Institute (ATMI) has announced its opposition to the proposed agreement due to the inclusion of the TPLs and cumulation. The Council is preparing an analysis of the proposed agreement, as currently understood, with respect to U.S. textile interests and the raw cotton segments. This analysis will be shared with the membership and Council delegates will likely seek to establish a position on CAFTA at the upcoming annual meeting.

While the U.S. imports about 18 million bale equivalents of cotton textile and apparel products, about 6 million bale equivalents is sourced from the CBI or NAFTA. Products coming from these regions are almost entirely made of U.S. cotton or cotton products. It is critical that the rules of origin for CAFTA preserve this relationship.

Mill use of cotton in the U.S. has declined to about 6.5 million bales in calendar 2003. Of that total, some 4.3 million bale equivalents of cotton products were exported and 94% of U.S. cotton textile exports go to the CBI and NAFTA. We must maintain the competitive position of shipping textile product to regional manufacturers. The portion of yarn spun in the U.S. for U.S. knitting or weaving continues to decline. It is only the ability to export textile products in this region that keeps U.S. mill use in the range of 6 million bales.

Free Trade Agreement of the Americas

There has been considerable discussion of a free trade agreement that would encompass the entire Western Hemisphere. The idea is to extend a NAFTA type agreement from Canada to Argentina. This is obviously a far more complex integration of trading economies than NAFTA. For cotton in particular, the nature of any trade agreement with Brazil must be carefully considered. Brazil has a large and diverse textile industry, and Brazil's capacity to increase agricultural production appears to be substantial. As you can well imagine, cotton is not the only agricultural commodity to express concern about a new trading arrangement with Brazil.

Again, a leading principle in considering any trade package would be avoiding 3rd party participation by constructing appropriate rules of origin for trade in textile and apparel products. Given the much wider scope of such an agreement, the Council engaged the firm of Jassin and O'Rourke, with the support of the Committee for Cotton Research Incorporated, to study the current structure and potential expansion of the regional textile complex. That study should be released in the very near future.

You just heard from Woody Anderson about a leadership tour of Brazil's major production region. That trip was taken, in part, to permit U.S. cotton grower leadership to see first hand the potential for cotton expansion in Brazil. Understanding Brazil's cotton and textile production potentials should help form the foundation of Council policy with respect to an FTAA. It should be noted that the difficulties encountered by the U.S. in the failed Cancun talks, due in part to the actions of Brazil, have recently focused USTR efforts toward an Andean trade pact rather than aggressive pursuit of a Free Trade Agreement of the Americas.

Bilateral Initiatives

U.S. Trade Ambassador Robert Zoellick has announced a large number of new bilateral trade initiatives in the past year while concluding several FTAs. It has been noted that the U.S. use of bilaterals may well be part of larger strategy to influence the WTO Doha Round of talks. If the Doha Round is not reconvened then we should expect an expanded effort on the part of the USTR to engage more countries in bilateral negotiations.

Each bilateral brings its own unique facets for the U.S. cotton industry. Some countries produce and export cotton, others have some or no textile industry while other countries could easily be ports of transshipment of Chinese textile products. The

Council continues to work with the various cotton interest organizations to assure an FTA will benefit the U.S. cotton industry and not non-participating 3rd countries.

The negotiations with Australia and Morocco are perhaps closer to conclusion than many others. The Dominican Republic could be folded into CAFTA if not concluded as an FTA. The 4 Andean countries of Columbia, Peru, Ecuador and Bolivia were introduced as 4 separate FTAs but it now appears that these countries could be part of a regional Andean Free Trade Agreement.

Brazilian Challenge in the WTO

Brazil has alleged that the U.S. cotton program has violated the WTO peace clause and done "serious prejudice" to Brazilian cotton interests. Brazil also charges that the Step 2 competitiveness provision and the export credit guarantee program violate the export subsidy code of the WTO agricultural agreement. The time period used by Brazil to define subsidies and damage is 1999 to 2001. This challenge is being heard by a WTO dispute settlement panel of three trade experts. The General Counsel of the USTR is the legal representative of the U.S. in this case. The WTO panel has stated its intention to release a preliminary finding in the case in May 2004.

The Brazilians hired a U.S. law firm (Sidley and Austin) a U.S. agricultural economist (Dan Sumner) and other U.S. experts to assist in their case. Professor Sumner is on the faculty of the University of California at Davis. He is the former chief economist of USDA and was an U.S. Department of Agriculture Undersecretary of Economics in 1991 and 1992. In turn, Professor Sumner appears to have hired Professor Bruce Babcock, an agricultural economist at Iowa State University and the director of the Center for Agricultural and Rural Development (CARD). CARD works along side the Food and Agricultural Policy Research Institute (FAPRI) at the University of Missouri in developing U.S. agricultural baselines and analysis for our Congress. Professor Babcock has helped Professor Sumner attempt to modify the FAPRI model for use by the Brazilians. This action was taken by Professor Babcock without the knowledge of FAPRI. In another time and venue there will be a full examination of the actions taken by these 2 economists.

Brazil's basic approach has been to aggregate all U.S. cotton program benefits (whether coupled or decoupled, whether marketing loan or crop insurance or step 2) and allege that the total of the payments must have caused added production and therefore lower prices. Those lower world prices, it is alleged, have harmed Brazil.

Brazil has attempted to argue that the nature of the payments, that is whether decoupled from planting or specifically linked to production is irrelevant. Brazil has claimed that the AMTA and supplemental AMTA payments under the FAIR Act and the direct and counter-cyclical payments in the new farm law still cause growers to produce additional acres of cotton, and therefore, Brazil alleges, the payments really aren't "decoupled." Brazil would have the WTO panel believe that marketing loan gains cause low prices rather than low prices causing increasing marketing loan gains.

Further, Brazil claims that the U.S. holds a disproportionate share of the world raw cotton market and our subsidies must remain high because the U.S. is a high cost cotton producer.

I believe that the lawyers and analysts of USDA and USTR along with Council staff have met every challenge, pointed out every flaw and presented an extraordinarily strong defense of the U.S. cotton program. Bill Gillon, the Council's former General Counsel, now employed by Butler, Snow, O'Mara, Stevens and Cannada serves as our legal counsel and has worked endless hours with Gary Adams, the Council's Vice President of Economic and Policy Analysis. The program knowledge and modeling expertise that Council personnel contributed to this effort were absolutely vital.

The papers submitted by USTR to the WTO panel can be seen on the USTR web site. These papers include statements regarding the U.S. view of the case, the operation of U.S. policy and rebuttals to claims made by the Brazilians and their hired economists. Brazil has invoked the right of confidentiality on their submissions to the panel and their papers are not yet public.

The "kitchen sink" approach taken by the Brazilians has made this highly complicated case more complex than any could have expected. The degree of complexity alone makes it virtually impossible to handicap how the WTO panel will decide. The concept of "green box" payments has been widely discussed but never defined or tested in a WTO dispute. Nor has a previous WTO dispute established what constitutes "serious prejudice" with respect to agricultural subsidy programs. This case could well define the parameters of a dispute for the next commodity contested under WTO rules. It could also significantly influence the future of WTO agricultural negotiations.

I believe that this challenge ultimately extends beyond the U.S. cotton program and is a fundamental threat to the conduct of U.S. domestic agricultural policy. The Council will continue to work with USDA and USTR to ensure that every effort is made to defend the U.S. cotton program in the WTO arena.

Conclusion

The National Cotton Council's trade agenda is full and trade policy now stands virtually shoulder to shoulder with farm policy in determining the ultimate success of the U.S. cotton industry. I believe the Council's policy development process has served the industry well in the past year. I look forward to another year of challenges with the knowledge that the commitment of industry leadership is unsurpassed and that USDA and USTR have a full appreciation of the Council's contributions to trade policy development and implementation.