Inside U.S. Trade

An Inside Washington Publication

An exclusive weekly report on major government and industry trade action

from Vol. 27, No. 49, December 18, 2009

BRAZIL, U.S. REMAIN IN STALEMATE OVER COTTON CASE SETTLEMENT

Brazil and the United States appear to be in a stalemate over negotiating a settlement of their bilateral cotton dispute, despite statements from both sides that they would be interested in exploring negotiations aimed at averting Brazilian retaliation over the U.S. failure to comply with World Trade Organization legal findings.

Brazilian officials last week discussed the cotton issue with a delegation from the Office of the U.S. Trade Representative, which had traveled to Brazil. However, that U.S. delegation, which was headed up by Assistant USTR for the Americas Everett Eissenstat, did not float any settlement ideas, one informed source said.

Instead, the discussion on the cotton dispute primarily consisted of Brazilian officials explaining to their U.S. counterparts the process Brazil is undertaking to prepare for retaliation. One source said the U.S. team also indicated that cross-retaliation is the most politically sensitive issue for the United States.

At a Dec. 14 event organized by the Woodrow Wilson Center, Philip Gough, trade counselor at the Brazilian Embassy, said the U.S. should make the first offer for a negotiated settlement in the dispute, which centers on U.S. cotton subsidies and the U.S. General Sales Manager (GSM) 102 loan guarantee program, which is used to help facilitate U.S. agricultural exports and which the World Trade Organization has ruled continue to violate WTO subsidies rules.

"We are there with the political will to negotiate [on a potential settlement], but we really expect the move to come from the U.S.," he said. The Brazilian government message to this point has been that the U.S. "should go first," he said.

Gough explained that while it is understandably difficult for the U.S. government to come up with suggestions for a possible settlement, it would be even harder for the Brazilian government to at this point attempt to "guess" at settlement ideas that could be politically feasible in the United States.

He also signaled that any negotiated solution may have to focus on the agricultural sector, as this is of primary interest to Brazil. "Most of our interests here, they are related to the agricultural sector in one way or the other, whether it is market access, subsidies, [sanitary and phytosanitary measures], whatever," he said.

One source added that a settlement will need to provide aid to Brazilian cotton growers who have been most directly affected by U.S. cotton subsidies.

Also at the event, Ricardo Mendes, the executive director of the Brazilian consulting firm Prospectiva Consultoria,

said that, based on his personal interactions with Brazilian officials, the Brazilian government appears "very receptive to alternative measures" to settle the dispute.

He also said the Brazilian private sector is "quite open" to alternatives such as financial compensation "at least until the problem of removing the [U.S.] subsidies is settled."

He added that Brazilian cotton exporters understand that U.S. farm programs cannot be radically overhauled overnight.

In addition to changing its cotton subsidies program, a narrow reading of the final WTO Appellate Body decision in the cotton case would also require the U.S. to terminate the GSM 102 program if it were to fully comply with the decision, according to a congressional source.

This is because the Appellate Body in its Article 21.5 compliance ruling found that the GSM 102 is not designed to cover its long-term costs. Due to this, the WTO faulted the program as a prohibited export subsidy.

Jon Huenemann of the law firm Miller and Chevalier said at the event that the Brazilian stance of demanding that the U.S. "go first" in the settlement discussions was worrisome because Brazil has not sufficiently clarified what it wants in a negotiated settlement.

He said both sides must work to advance beyond this current stalemate where Brazil urges the U.S. to make the first move, and the U.S. declines to float substantive settlement offers.

But a congressional source earlier this month said that the Obama administration is wise to wait for Brazil to indicate what settlement it could consider acceptable. Otherwise, the U.S. would be negotiating with itself, he said.

The U.S. last month urged Brazil to float ideas for a possible settlement (*Inside U.S. Trade*, Nov. 20). U.S. Trade Representative Ron Kirk said in Geneva earlier this month that the U.S. will do all it can to find a negotiated solution to the bilateral dispute (*Inside U.S. Trade*, Dec. 4).

Huenemann said that a resolution to the dispute will be impossible unless Brazil tones down its expectations of how much U.S. subsidy programs can change in the short-term. "If Brazil thinks that, through this exercise, it is going to measurably and in very significant ways, by itself, move the ticker [on subsidies], I think we are headed for a train wreck," he said.

He further argued that it could be advantageous for the U.S. and Brazil to agree to a negotiated settlement within the context of the Doha round of global trade talks, as the U.S. may be unwilling to make the necessary changes to its farm programs in isolation.

"The reality is that the United States has been negotiating in the context of Doha on the premise that its domestic support programs are something ... that has to be dealt with in a multilateral context, politically, and even then it will be difficult," he said. Finding a multilateral solution could allow all parties "to declare victory and go home" because domestic support reductions could be offset by U.S. gains in other areas, he suggested.

At the same time, he acknowledged it remains unclear when and whether the long-stalled Doha round will conclude. Several observers also downplayed this approach for the same reason.

Huenemann suggested that one possible option for settlement could involve more market access for Brazilian ethanol exports. "If you ask some people in the U.S. production agriculture community what the biggest problems they face are, they will say the ethanol program here in the United States," he said.

The U.S. cotton industry "would probably be quietly cheering if Brazil was able to negotiate some progress on the ethanol issue," he said. At the same time, he acknowledged that progress on this issue was politically difficult. Brazil has pressed the U.S. to reduce its 54-cent-per-gallon tariff on imported ethanol within the context of the Doha round negotiations (*Inside U.S. Trade*, Aug. 8, 2008). That tariff expires on Dec. 31, 2010.

Mendes argued that the U.S. and Brazil need to devise a settlement that is in line with WTO rules and WTO principles of increasing trade and cooperation between countries.

To that end, he suggested that the two sides could work out an arrangement involving both financial compensation for Brazilian cotton growers, and also increased market access into the U.S. market for Brazilian exporters. He said that granting such access is complicated by WTO most-favored nation rules, but said this could be dealt with by lowering sanitary and phytosanitary (SPS) barriers facing some Brazilian exports, such as beef.

Mendes pointed out that the U.S. imports much less than the average share of what Brazil exports to the world market. If the U.S. were to allow market access for Brazilian exports equal to the market share Brazil holds on the world market for the products directly involved in the bilateral dispute, that would be worth roughly $260 million, he estimated. Doing the same for all agricultural products would be worth $2.1 billion, he said.

Both of these approaches have precedent under the WTO, Mendes said. In response to an adverse decision concerning a Japanese beverage tax, Japan decided to negotiate a settlement based on the premise of providing greater market access for foreign products.

In a case between the U.S. and European Union that concerned music copyrights, the U.S. negotiated a settlement that involved cash payments to the EU, he said.

As an interim settlement in that dispute with the EU, the U.S. agreed to pay $1.1 million a year into an EU young artists' fund for three years. That settlement ended in 2004, but the dispute has lingered since then. To comply with the ruling, Congress would have to change Section 110(5)(B) of the U.S. Copyright Act, which allows certain bars and restaurants to play copyrighted music without paying royalties, or renew a compensation arrangement with the EU.