

IN THIS ISSUE!

Why the global Cotton Price is falling Ludwig Chizarura	Pages 1-3
Brazil Vs USA: Whither Africa? Elijah Munyuki	Pages 3 – 7
Editorial: Unweaving institutionalized poverty: African countries must unite against US cotton subsidies Rangarirai Machededze	Pages 7-10

Why the Global Cotton Price is Falling

Ludwig Chizarura

Approximately 200,000 farmers grow cotton in the arid and semi-arid regions of Zimbabwe. It is vital for ensuring food security, maintenance of rural economic livelihoods and generating foreign currency for the country. Over the last three years, cotton has overtaken tobacco as the country's biggest foreign exchange earner bringing in export revenue of well above US\$150 million. Zimbabwe produces around 300 million kg of cotton annually, out of which 70% is exported to the international market while 30% is reserved for domestic textile industry. However, with Zimbabwe generating millions of dollars in cotton the situation could be better if international prices were stable and fair for producers.

Zimbabwe and developing countries alike have been reeling under the effects of falling global prices of the commodity over the last ten years with disastrous consequences on farmers' income and government export revenues. The last three seasons in Zimbabwe witnessed price wars between the farmer organisations requesting fair prices and cotton merchants offering low prices for the commodity, reflecting global price levels. During the 2003-2004 season farmers demanded Z\$3000.00 (US \$ 0.56) per kg while the merchants were prepared to pay Z\$ 1800.00. (US\$ 0.34) per kg. The impasse was only resolved after the intervention of the Government and the Governor of the Reserve Bank of Zimbabwe with a compromised price of Z\$1900.00 (US\$ 0.36) per kg, clearly disadvantaging growers. This year the merchants are reportedly offering

Z\$1000.00 (US\$ 0.16) per kg far lower than the last season's final producer price, while the farmers are demanding a much higher figure in order to cover the steep increases in costs of inputs.

The polarised positions of growers and merchants are quite understandable. Inherently the two parties have potentially conflicting interests. Both parties are in the cotton business in order to survive. The growers seek to maximise their farm incomes from producing the crop while merchants also want to make the most earnings from marketing the crop. Therefore for each party to achieve its objective, growers seek the maximum price that they can get from seed cotton while merchants are determined to buy the commodity at the lowest possible price. When the chips are down, i.e. the global price falling (which has been the trend over the last 5 years), then conflicts inevitably arise on fixing the producer price.

The cotton merchants base their price setting on the international price while the growers take into account the costs of production. As alluded to already, the falling international price is at present well below the aggregate average cost of production such that compelling growers to accept it is tantamount to impoverishing them or forcing them to go out of business.

At the national level price negotiations are not between two parties with equal negotiating powers. The merchants have more information, knowledge on cotton trade and above all are better organised than the growers. Furthermore, they have the funds earmarked for buying seed cotton from growers on behalf of multinational companies with whom they are regularly in contact on marketing conditions, therefore they can exert

their influence to get maximum benefit from the transactions.

Internationally, the depressed cotton price is due to the United States (US) and to some extent European Union (EU) CAP subsidisation policies on agriculture, a subject of unending debate at the multilateral trade talks. The difference between the US and EU is that the former produces large exportable quantities that depress global prices whilst the latter reduces the export market for exporting developing country markets because the EU mainly produces for domestic textiles industry.

Since the mid-1990s there has been a remarkable shift in the US policy from supply control programs to demand - driven (especially export demand) resulting in overproduction of agricultural commodities that presses down global prices to levels well below the cost of production. In 2003 cotton was exported at an average price of 47% below cost of production. Cotton dumping levels increased from an average of 29.4% pre-1996 Farm Bill to an average of 48.4% post 1996 Farm Bill. At present the US accounts for 40% of the world total cotton exports. The rich countries farmers are subsidised for the loss of potential income from the market, a practice that developing countries cannot do due to poverty. Empirical evidence provided by OXFAM International illustrates the disparities between rich and developing countries price support to farmers.

There is an almost immeasurable difference between the highest and lowest subsidy paid to farmers. During the cropping season 2001/02, Spain subsidised its farmers to the tune of US\$0.76/lb (US\$1.67) and Cote d'Ivoire could only assist its farmers

with US\$0.03/lb (US\$ 0.07/kg). In the case of rich countries the subsidies are in fact increasing with that of Spain having increased by 42% while the paltry support provided by developing nations has remained fairly static.

In the case of Zimbabwe there are no price support programs for the farmers. For the current season, the Z\$1000/kg (US \$ 0.16) that the merchants are offering is over 13 times below the subsidy a Spanish farmer gets for every kilogram of cotton they produce.

The practice of dumping, i.e. selling cotton below cost of production has three profound negative effects on developing country farmers. Firstly below-cost imports drive the farmers out of their markets if they do not have safety nets of subsidies and credit. Secondly, the domestic market for cotton, the domestic textiles industry will tend to buy the cheap cotton on the global market, so that the cotton producing country cannot even process its own raw materials. Thirdly for exporting countries, the farmers find their traditional markets flooded by cheap subsidised cotton from the US. Recently Brazil took the US to the WTO Trade Disputes Court and won its case even after an appeal. It is a complex politico-economic issue involving rich and powerful forces that the cotton merchants themselves dare not challenge.

Unfortunately in Zimbabwe, as in many other cotton producing developing countries, the tendency by the media as well as the government is to shift the blame of reduced revenues on the suffering peasants without taking into account the international dimension. The global price is taken as given by market forces. The unfair trade distorting policies of the rich countries are not considered, thus the

analysis wittingly or unwittingly tends to be biased in favour of the merchants at the expense of the livelihoods of the growers. There is actually a need for both parties to cooperate constructively as well as for the government to intervene in the price setting process to ensure that producers get a fair share of revenues, as opposed to pushing one party to be a price-taker regardless of the prevailing conditions. Also, there is a need for governments of cotton producing countries again to take common action to negotiate the global prices and so that the majority of the revenue remains in the countries.

Ludwig Chizarura is a senior Analyst and Research Fellow with SEATINI

Brazil vs USA-Whither Africa?

Elijah Munyuki

The *United States- Subsidies on Upland Cotton* dispute concerned US domestic support measures and other measures which Brazil alleged are export subsidies. Brazil alleged that the measures were inconsistent with the US obligations under the *Agreement on Agriculture (AOA)*, the *Subsidies and Countervailing Measures Agreement (SCM)* and the GATT 1994. Africa has several countries which produce cotton. The WTO ruling on the cotton dispute was sparked by a complaint by Brazil. Where was Africa in all this? What is the implication for Africa?

USA Domestic support measures

It is not easy to understand some of the measures referred to by reading the Appellate Body's Report, rather one must revert to the original Panel Report for a better picture. The Panel summarised the nature of the US domestic support regime in its report.

In short the USA's domestic support measures consisted of:

- Marketing loan/Loan deficiency provisions;
- User marketing (Step 2) provisions;
- Direct payments provisions;
- Counter-cyclical payments provisions;
- Crop insurance provisions; and
- Export credit guarantee provisions

These schemes involved huge sums of money, for example, the export credit guarantees involved amounts of not less than US \$5,500,000,000. The Panel ruled this subsidy regime for cotton to be inconsistent with the USA's obligations under the WTO framework, finding that the subsidies had caused a significant price suppression. The Panel recommended that the USA should remove the offending subsidies. The USA subsequently appealed to the Appellate Body (AB) of the DSU which upheld most of the Panel's ruling. The AB recommended that the Dispute Settlement Body request the USA to bring its measures into conformity with its obligations under the *Agreement on Agriculture* and the *Subsidies and Countervailing Measures Agreement*.

Where was Africa in this dispute?

Of all the cotton producing countries in Africa only Benin and Chad involved themselves in the dispute. They did so as Third Parties, a procedure permissible under art.10 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes*. These African countries were joined by Argentina, Australia, Canada, China, the EU, India, New

Zealand, Pakistan, Paraguay, Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu ("Chinese Taipei") and Venezuela who all reserved their rights to participate in the Panel proceedings as third parties. Evidently the bulk of Africa was glaringly absent from this important dispute. As the Panel noted the participation of Benin and Chad was as follows:

- Benin provided a detailed written submission and presented an oral statement at the first session of the first meeting of the Panel. It provided written responses to the Panel's questions following that session;
- Benin and Chad made a detailed joint written submission, and presented separate oral statements, at the resumed session of the first meeting of the Panel. They provided joint written responses to the Panel's questions following that session;
- in their joint submission, Benin and Chad extensively explained the situation of the cotton sector in their respective countries;
- Benin, which has a permanent mission in Geneva, was represented by a delegation headed by its Ambassador, which included a research fellow of the International Food Policy Research Institute, who presented the results of a study entitled "*Effect of falling cotton prices on rural poverty in Benin*";
- Chad, which does not have a permanent mission in Geneva, was represented at the resumed session of the first substantive meeting by a delegation headed by its

Brussels-based Ambassador, who presented a detailed statement by the Chairman of the *Société Cotonnière du Tchad* ("*Cotontchad*") and the *Association Cotonnière Africaine*, Mr. Ibrahim Malloum; and

- Benin and Chad had legal advisers from a private law firm.

Benefits of Third Party Participation

This participation was obviously intended to bring about tangible results. However interesting arguments were raised at the Panel stage, and also dealt with at the Appellate Body phase which would have rendered Benin and Chad's efforts futile. The Panel found that the US support measures had caused "significant price suppression" and this amounted to "serious prejudice" upon Brazilian producers of upland cotton. However it was also Brazil's assertion that other WTO Members, in particular African cotton-producing Members, had suffered serious prejudice as a result of United States subsidies. The US countered this assertion by arguing that it was only the interests of Brazil as a complaining party which were at issue. In other words the interests of the African cotton-producing Members, including those of Chad and Benin were irrelevant. If accepted, the USA's argument would have meant that Benin and Chad had wasted time and money on a futile exercise.

The EU agreed with the USA that only the price effects on the products of Brazil were relevant. Benin and Chad submitted that the Panel was required to take account of the effects of the USA subsidies on the interests of Members other than the complaining Member, arguing that if art.24.1 of the DSU has any meaning, the special

situation of Benin and Chad had to be given full and substantive consideration by the Panel. The Panel's ruling on this issue is interesting. The Panel noted that art.7 of the SCM Agreement sets forth steps to be taken by a Member that believes that it has suffered adverse effects within the meaning of Part III of the agreement. It was the Panel's view that serious prejudice under examination by the WTO panel is the serious prejudice experienced by a complaining Member since it is that Member which would have initiated the dispute settlement process. This view was further twisted by the Panel's observation that in view of art.10.1 of the DSU, the Panel is bound to take the interests of the parties and those of other Members under the SCM Agreement into account during the Panel process. In the Panel's reasoning this meant the interests of *all* WTO Members, interestingly the Panel said;

"In taking such full account of all Members' interests, we do not view it as conceptually or practically possible to take certain Members' interests *more fully* into account than those of other Members."

In short the Panel meant that there was nothing special about the situation of Benin and Chad. The submissions by Benin and Chad were taken *only* as evidence in support of the effect of the subsidy borne by Brazil as a Member whose producers are involved in the production and trade in upland cotton. In effect the Panel's decision was not based on any alleged serious prejudice caused to other Members, Chad and Benin included.

Serious prejudice to who? The Appellate Body Ruling

Benin and Chad raised this issue in the AB proceedings. They argued the evidence before the Panel indicated that those Members that lost market share as a result of the price-contingent subsidies include, at least, Brazil and the “Francophone African nations of Benin and Chad” (the reference to “Francophone African” is quite puzzling). Benin and Chad disagreed with the Panel’s finding that “the serious prejudice under examination by a WTO panel is the serious prejudice experienced by the complaining Member.” Benin and Chad argued that the AB should take in to account the impact of USA upland cotton subsidies on the “fragile economies of West and Central Africa” as reflected in the Panel’s findings and evidence on the record. The two countries further pointed out that art.24.1 of the *DSU*, which requires particular consideration to be given to the special situation of LDC Members, would be given meaning if the AB acknowledged that the increase in the USA’ world market share caused serious prejudice to Benin and Chad by reducing their market share. Therefore, Benin and Chad urged the AB to draw conclusions that would require the USA to withdraw the subsidy or remove the adverse effects, not only with respect to Brazil, but also with respect to Benin and Chad.

The AB’s ruling on this point is linked to Brazil’s appeal regarding the interpretation of the phrase “market share” for the purposes of art.6.3(d) of the *SCM Agreement*. Benin and Chad had requested the AB to find that their interests had suffered serious prejudice in the sense of art.5(c) of the *SCM Agreement*, if the AB were to find that Brazil suffered serious prejudice as a result of an increase in the USA’s world market share. The AB did not find it necessary to rule on Brazil’s

appeal regarding the interpretation of the phrase “market share” in art.6.3(d). Consequently the AB ruled that it was not “in a position to accede to Benin and Chad’s request to complete the analysis and to find that, in addition to Brazil, Benin and Chad also have suffered serious prejudice to their interests. On this technicality alone, the end result is that the participation of Chad and Benin in this case only served as other evidence pointing to the grievances of Brazil.

Quite clearly both the Panel and the Appellate Body did not see the plight of the cotton producers of Benin and Chad as an issue. Whatever measures the USA will take with respect to removing the subsidies at issue, or removing their adverse effects relate to the serious prejudice occasioned on Brazil. Any benefits accruing to Benin and Chad may only occur because Chad and Benin are just other Members of the WTO. This technicality leaves open the question which the Panel answered in the negative, namely, if Benin and Chad as third parties could be regarded as having suffered serious prejudice (even though evidence of the plight of cotton producers in both countries was deduced and largely unchallenged!). A waste of time for the African participants?

Even though the AB did not rule directly on the point, the lesson to be drawn from this case is that third party actions are not a guarantee that the WTO will adjudicate on the merits of such claims. In a sense where a WTO Member has a substantive case it is suicidal to append such a case to the claim of another Member. The dispute settlement procedure begins with the consultation process. From there on the issues are defined, joining the case at the Panel stage restricts the late

comer's options. It seems the case that the WTO guarantees the procedural, and not the substantive rights of third party participants. This point stems from the reasoning of the Panel with respect to Benin and Chad's request for a substantive finding of serious prejudice in their circumstances. Cruel though it may seem, it is worth asking why, if Benin and Chad strongly felt they had a case, they did not initiate the dispute settlement procedure against the USA or any other guilty WTO Member state. Numerous papers have been written on the supposed negatives of the WTO dispute settlement mechanism in relation to the poorer countries. Without submitting that the procedure is perfect, it can still be argued that it is there to be utilised, by all WTO Members. It is a question of priorities. We are not talking here of the sanctions regime pertaining to the WTO framework, which has been described as discouraging smaller Members from bothering to initiate disputes against bigger blocs like the EU or the USA for that matter. The issue is mainly that if a WTO Member has a serious case there is more to be gained by putting it before the dispute settlement body. Questions of expense are often raised, but it is a question of priorities; ultimately the economic interests of citizens are far more important and worth defending, and are a far more justifiable expenditure than the numerous questionable spending decisions of many WTO Member states. For the time being, the suffering of the peasants of Benin and Chad, and the rest of Africa (which did not bother to participate) is irrelevant. It is for Africans to make it relevant.

Linking the WTO Ruling with the Doha round

It remains to be seen what the USA would make of the AB ruling.

However both the Panel and the AB rulings may have an impact on the current negotiations pursuant to the Hong Kong meeting. The rulings should be closely scrutinised as a matter of urgency since they have an impact on the agricultural negotiations. Depending on events, the rulings just might have an influence on the negotiating positions of various WTO Members. It is far too early and mistaken to celebrate the AB ruling as indicative of the demise of trade-distorting subsidies.

Elijah Munyuki is a Senior Analyst and research fellow with SEATINI

Editorial: Unweaving institutionalised Poverty: African countries must unite against US cotton subsidies

Rangarirai Machedze

There is a development cataclysm that has evolved largely unnoticed over the past decade. It is the cotton crisis that has affected millions of farmers in most developing countries particularly in West Africa where cotton growers have been driven out of production as a result of artificially managed low prices at the world market. Cotton growers in Southern Africa, particularly Mozambique and Zimbabwe have also been plunged into deep poverty, as incomes from cotton farming continue to dwindle under armpits of an all time low prices offered by cotton merchants.

It is not just the cotton sector, which has been affected, but all the other dependent industries like the textiles which have for years been providing employment to millions of people in developing countries.

As the first article in this *Bulletin* notes “the problem of low world prices of cotton has largely been influenced by the huge subsidies that Cotton farmers in developed countries get from their governments”. That is true. The subsidies given by cotton producer countries of the North, especially the US, cut world cotton prices by at least 25 per cent causing serious problems for their small and vulnerable economies. The US gives its farmers huge domestic support for agriculture. It was raised to a record \$180 billion over a 10-year period under the 2002 Farm Bill, including \$3 billion for cotton farmers. This effectively means the farmers are subsidised to the tune of \$18 billion year.

During the 2001/02 season, the US spent about \$3.9 bn on subsidies and other supports to its 25,000 cotton farmers-- double the 1992 figure. These subsidies have encouraged overproduction in the US, resulting in the flooding of the world market by cotton sold at prices less than it costs to produce. This has depressed prices to levels at which competitors struggle to survive.

With low labour costs and small manageable plots, farmers in Zimbabwe and Mozambique are among the lowest-cost producers of cotton in the world.

The International Cotton Advisory Committee puts the cost of producing a pound of cotton in Burkina Faso at 21 US cents compared to 73 cents in the US itself. However, state subsidies guarantee a minimum price to US farmers -- currently about 52 cents per pound -- regardless of what happens to world prices. US farmers also receive additional payments to top up their income to a target price level. As a result, they continue to expand cotton

production -- by 42 per cent between 1998 and 2001 -- oblivious to almost five years of depressed world prices. In 2003, partly due to the continuous flooding of the market by US cotton, world cotton prices fell to 42 cents per pound, far below the long-term average of 72 cents. During the 2001/02 season, the US government paid more to its cotton farmers in supports than the value of the harvested crop -- \$3.9 bn in subsidies for a crop valued at \$3 bn.

At the Fifth Ministerial Conference of the WTO in Cancun in September 2003, four West African cotton producing countries of Benin, Burkina Faso, Mali and Chad sought to get the WTO to consider the case of their cotton industry on which depend, directly or indirectly, the livelihood of the bulk of their populations.

Although the four countries took the initiative to bring the case of cotton, it is an issue that affects many other countries in Africa and the third world. For example, at its peak, the cotton industry was Tanzania's largest employer, with 14 textile and spinning mills, employing nearly 35,000 people. As a direct result of the impact of trade liberalisation, most of the factories have closed down, and today its contribution to the national economy is insignificant.

A study conducted by the International Cotton Advisory Committee (ICAC) in 2002 has shown that one of the major crops adversely affected by agricultural subsidies US and Europe was cotton in Africa, where farmers lost about \$250 million annually. The study, titled "Production and trade Policies Affecting the Cotton Industry", says that the losses incurred by Africa's cotton sector were directly related to the subsidies by the West.

The Cancun conference failed to take off the ground for other reasons, but not before the four West African states had made their point. It was widely recognised that in the interest of equity and fairness, the rich countries, especially the US (for whom cotton is a tiny issue compared to its GDP), should eliminate subsidies that were depriving the livelihood of millions of poor peasants in African countries. The matter, however, was unresolved. The US rejected the West African initiative, twisting the debate around the issue of “sectoral support” to the textile industry to Africa under the Africa Growth and Opportunities Act (AGOA).

The cotton initiative of the four West African countries had the support of the African Union, the LDC group and the ACP group. These countries met in Mauritius in July 2004 (as G90 countries -- an alliance of these small countries was forged at the Cancun conference), and one of the paragraphs in the draft resolution called for strong support for the cotton case. The meeting, however, was attended by Robert Zoellick, the United States Trade Representative. On the last day, when the resolution finally came for adoption, the chairman of the Africa group, the Minister from Rwanda, backed by the Ambassador of Uganda (two close allies of the US in the Iraq war) argued that the cotton paragraph be removed because “it won’t fly”. A compromise draft was eventually worked out, and brought to Geneva as a basis for further negotiations.

In Geneva, at the start of the General Council meeting of the WTO in July, the Africa Group put forward its proposal that included the following: that all forms of cotton export subsidies are eliminated by date of

implementation of the Doha results; more than average reductions in domestic support on cotton, and complete elimination of all forms of trade distorting support on cotton by a specific year; a cotton agreement shall be implemented on an early harvest basis starting in 2005, and a date for total elimination of cotton subsidies shall be determined by the next Ministerial irrespective of progress in the rest of agriculture negotiations; technical and financial assistance to meet the needs of cotton developing-country producers; and a working group on cotton to be established.

During the week, Bob Zoellick held a marathon all-night 12-hour meeting with some of the West African countries on the cotton issue. By the end of the negotiations, the cotton issue was more or less dismissed in the so-called July package of the WTO. The four West Africa countries had been “persuaded” to give up their original demand that cotton be treated as a stand-alone issue. They “agreed” that it could be considered within the agriculture negotiations, but be treated as of “special status”. It is clear that despite claims made by the WTO officials, the US has clearly won out. In a compromise text clouded by technicalities, it was agreed that while product specific AMS support (Aggregate Measure of Support plus permitted *de minimis* plus the Blue box payments) is to be capped in aggregate and reduced in overall terms, there is no requirement for specific product cuts, including for cotton.

It is worth noting that the case won by Brazil in the petition with WTO settlement body as explained in the third article of this *Bulletin* should work as the basis for putting a lot more pressure at the WTO for the rules to work best for everyone, for the

subsidies to phased out within a reasonable time period and for the African countries to be afforded the flexibility to exercise their fundamental human rights. One of them being the right to life.

As we move towards Hong Kong, African countries must develop strategies and tactics to build on their already firm positions and be strong enough to defend those positions

particularly on Agriculture, which is the mainstay of millions of people.

Southern Africa already has now embarked on a cotton campaign programme, to rescue the sector and the textiles industry from the jaws of collapse. It is a worthy cause, which should be supported by everyone.

Rangarirai Machedze is the Acting Director of SEATINI.

Editor: Chandrakant Patel

Advisor on SEATINI: B. L. Das,

Co-Editors: Percy F. Makombe; Rangarirai Machedze, Riaz Tayob

Editorial Board: Chandrakant Patel, Jane Nalunga, Riaz Tayob, Percy Makombe and Yash Tandon

For more information and subscriptions, contact SEATINI, 20 Victoria Drive, Newlands, Harare, Zimbabwe, Tel: +263 4 792681, Ext. 255 & 341, Tel/Fax: +263 4 251648, Fax: +263 4 788078, email: seatini.zw@undp.org, Website: www.seatini.org

Material from this bulletin may be freely cited, subject to proper attribution.